

No. 16010

---

United States  
Court of Appeals  
for the Ninth Circuit

---

GENE O. CLARK and FAYE CLARK,  
Petitioners,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

---

Transcript of Record

In Two Volumes  
VOLUME II.  
(Pages 281 to 523, inclusive)

---

Petition to Review a Decision of The Tax  
Court of the United States

FILED

MAY 23 1958

PAUL R. DUNN, CLERK



No. 16010

---

United States  
Court of Appeals  
for the Ninth Circuit

---

GENE O. CLARK and FAYE CLARK,  
Petitioners,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

---

Transcript of Record

In Two Volumes  
VOLUME II.  
(Pages 281 to 523, inclusive)

---

Petition to Review a Decision of The Tax  
Court of the United States

---





(Testimony of Frederick W. Files.)

Redirect Examination

Q. (By Mr. Machtinger): With respect to the dividend to Mr. Clark in the sum of \$20,000 for which there is a journal entry dated April 30, 1948, was that paid to Mr. Clark by check or cash?

A. Paid to Mr. Clark with a corporation check.

Q. Did Mr. Clark ever turn back that check to you?      A. No, sir.

Q. To your knowledge, did Mr. Clark deposit that check to the account of the corporation? [170]

A. No, sir.

Q. What did Mr. Clark give back to you?

A. He gave me back certain other checks totaling \$20,000 which were deposited to the account of the corporation and credited to Mr. Clark's account, notes receivable.

Q. What type of checks were included among the total of \$20,000 which you used for the entry to which I refer you?

A. I don't remember the instruments. They were substantial checks.

Q. To your knowledge, do you recall whether any of those checks consisted of checks from customers of the corporation which were made in payment of corporate goods?

A. I don't understand that.

Q. Were any of the checks that you received——

Mr. A. Baird: Just a moment, Mr. Machtinger, I don't know what you are getting at, but it seems to me that it is wholly immaterial.

(Testimony of Frederick W. Files.)

The Court: I certainly disagree with you, Mr. Baird. I think it is highly material.

Mr. A. Baird: Then I don't understand what counsel is doing.

The Court: Well, let him bring it out in his own way, unless you want him to tell the witness in advance. I think it is highly material.

Mr. Machtinger: If counsel has no objection to my [171] stating where I am going, I want to bring out that the \$20,000 dividend that was paid to Mr. Clark by check was not turned back to the corporation at all but that Mr. Clark used other proceeds which he had received and which I believe to have been proceeds from the sale of corporate goods and which he applied against this so-called \$20,000 which was turned back to the corporation.

It is my contention that there was a \$20,000 dividend, but that that dividend was not turned back.

Mr. A. Baird: Well, am I to understand that the position of the Government is that Mr. Clark did not apply the \$20,000 from some source in payment of the note, account receivable on the books of the company?

Mr. Machtinger: I would like to ask the witness questions pertaining to that fact to discover whether whether or not Mr. Clark did turn back the \$20,000 which the corporation paid to him.

Mr. A. Baird: It seems to me immaterial what \$20,000 we are talking about.

The Court: It is immaterial to what \$20,000,

(Testimony of Frederick W. Files.)

Mr. Baird, but it is very material as to whether there were two \$20,000 or one \$20,000.

Mr. A. Baird: If that is what he is trying to do, I have no objection.

The Court: I can't imagine what else he is getting [172] at.

Mr. Machtinger: That is the sole point that we are trying to prove, if we can, and if the witness has knowledge of facts of that nature.

Q. (By Mr. Machtinger): Mr. Files, you state that the corporation paid Mr. Clark \$20,000 check which represented a dividend, is that correct?

A. I believe the check was.

Q. Somewhat less, wasn't it, \$19,000—

A. \$999.82, something like that, yes, sir.

Q. Did Mr. Clark ever turn that check back to you? A. No, sir.

Q. And you testified, I believe, that Mr. Clark did turn back an equivalent in cash and other checks, is that correct?

A. I don't recall the currency or what it was composed—if I remember, it was all checks.

Q. Approximately how many checks, if you recollect?

A. I don't recollect, sir, the amount of checks.

Q. Do you recollect at all whether any of those checks represented payments by customers of the corporation for goods that those people had purchased, those customers had purchased?

A. I believe some of the names were familiar to me, regular customers of ours. [173]

(Testimony of Frederick W. Files.)

Q. Do you recall whether you applied the \$20,000 against accounts due from those customers or whether that \$20,000 was used solely with respect to the dividend entry to which we are referring?

A. The \$20,000 was credited to notes receivable, officers.

Q. Thank you, Mr. Files.

Did the corporation, to your knowledge, ever engage in the business of farming?

A. No, sir, not as such. We were on the fringes of it, but as such——

Q. Did you ever issue any checks in payment of farm expenses?

A. We maintained an account in the Citizens National Bank in Maywood under the heading Special Account No. 1, and I forget the amount involved. That particular account was used by Mr. Clark's father in Kansas to pay certain operating expenses on the farm.

Q. When you say "we maintained," are you referring to the——

A. I mean the corporation, yes.

Q. How did the corporation place funds in that account?

A. By cross deposit from our regular account.

Q. Did you maintain on your books and records as an asset—— [174]

A. Yes, sir.

Q. Did you deduct on the books and records as expenses the items, the withdrawals of funds from that account?

A. I can't recall right now, but I believe that

(Testimony of Frederick W. Files.)

that was held separately, was just for that interim period in which we didn't know whether the corporation was going to own it or whether the officers were going to own it.

Q. When you say "in the interim period" when you didn't know who was going to own it——

A. Yes, sir.

Q. Do you know who, as a matter of fact, who did own it?

A. No, I don't. I was just accounting for the money but it was turned over to Mr. Clark to purchase it.

Q. After you were advised or to your knowledge after the corporation was advised that it could not hold in its name property in Kansas, did you continue to place funds in this separate account?

A. I don't recall, Mr. Machtinger.

\* \* \* \* \*

#### Recross Examination

Q. (By Mr. A. Baird): Mr. Files, I will ask you if the amounts to which you referred as being deposited in this special account at the [175] Citizens National Bank in Maywood wasn't approximately \$5,000?

A. You mean for Special Account No. 1?

Q. Yes.

A. I don't recall the amount. That could have been, yes, about 5, perhaps.

Q. I want to show you, this is Petitioners' Exhibit No. 19, and ask you if it isn't a fact that the



(Testimony of Frederick W. Files.)

amount so deposited was later changed back to the officers?

A. I don't know, sir. I would have to see the detail of the entries. This is just the general ledger account.

Q. I don't know whether I can get it for you or not. You can't recall? A. No, I cannot.

Q. One way or the other?

The Court: Probably has a journal reference. If you have any great reason to go into it, we have got the books here.

Q. (By Mr. A. Baird): Mr. Files, I show you the journal entry No. 20, dated 12-31-46, and ask you what that entry indicates to you?

A. The entries under the date of December 31st, 1946, there is a \$5,000 debit notes receivable and a \$5,000 credit to cash in bank reserves. The title of the journal entry or the explanation is "To transfer reserve account in the notes payable as the above reserve was loaned to Clark and Koyl for [176] maintenance of Kansas property." I believe the account here is in error, that ought to be notes receivable. I didn't make that entry, Mr. Kay made it.

Q. Does that refresh your recollection now?

A. It does, yes, I believe that is how the account was eventually closed out.

Q. So that the amounts that went into that special account ultimately came back into the corporation in the form of notes receivable?

A. Yes, sir. Well, they never were beyond—the

(Testimony of Frederick W. Files.)

amounts were an asset of the corporation, sir.

Mr. A. Baird: That is all.

### Redirect Examination

Q. (By Mr. Machtinger): In connection with that entry, the entry says that the \$5,000 was loaned. Was that under the theory that the property was owned by the individuals and the corporation was merely loaning that money for the purpose of maintaining the property? A. Yes, sir.

Mr. Machtinger: That is all. [177]

\* \* \* \* \*

### DONALD PHILLIPS

a witness called by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: Donald E. Phillips. [181]

\* \* \* \* \*

### Direct Examination

Q. (By Mr. Gardner): Are you the same Donald Phillips that testified in the case of Archie Koyl and Fawn Koyl? A. I am.

Mr. Gardner: Inasmuch as his testimony is already in the record by stipulation, I will dispense with the preliminary questions to this witness.

Mr. T. Baird: Surely.

Q. (By Mr. Gardner): Mr. Phillips, did you examine the income tax returns of the corporation known as Gene Clark, Inc.? A. I did.

(Testimony of Donald Phillips.)

Q. Did you examine the books and records of Gene Clark, Inc.?      A. I did.

Q. Did you examine the income tax returns of Gene Clark and Faye Clark?      A. I did.

Q. For the years 1946, 1947, 1948 and 1949?

A. I did.

Q. Based on your examination of the books and records of the corporation, of your examination of the income tax returns [182] of the corporation, did you prepare a report recomputing the corporation income for the years involved, that would be 1946, 1947, 1948 and 1949?

A. Would you read that?

Q. The fiscal years ending April the 30th of each of those years?      A. Yes, I did.

Mr. T. Baird: There was no fiscal year——

Mr. Gardner: With the exception of 1946.

Q. (By Mr. Gardner): Is this the report that you prepared, Mr. Phillips?      A. Yes, sir, it is.

Mr. Gardner: Although this report has been incorporated into this case by stipulation, it probably would be well to get a number for it for identification.

Mr. T. Baird: I think we have one, Mr. Gardner.

Mr. Machtinger: I don't think so, Mr. Baird.

The Clerk: It is G in the other case, but has no number in this case.

Mr. T. Baird: If there isn't, then that's fine. I would like to have it a co-exhibit.

Mr. Gardner: All right. It is stipulated that it



(Testimony of Donald Phillips.)

will come in as Respondent's next in order and Petitioners' next in order.

The Clerk: Joint Exhibit 20-WW. [183]

(The document above referred to was marked Joint Exhibit 20-WW for identification and received in evidence.)

Mr. T. Baird: I would like the Court to understand, of course, it is for the limited purpose stated previously.

The Court: Is that agreeable to you?

Mr. Gardner: Yes.

The Court: Very well.

Mr. Gardner: And also included in the stipulation, certain schedules from which he prepared the report. I would like to have these, have a separate identification——

Mr. T. Baird: Excuse me. Were these with the report we have access to or are these work papers of some kind?

Mr. Gardner: These are other work papers on which the Revenue agent's report was based.

Mr. T. Baird: I don't stipulate to those.

Mr. Gardner: Those are already in.

Mr. T. Baird: In the other case.

Mr. A. Baird: Maybe I can straighten this out. As I understand it, we had a stipulation to the effect that the testimony of the witness Phillips would be used in this case—of the witness Phillips in the Koyl case could be used in this case as though he had testified here and that all exhibits to which he referred would also come in and that we

(Testimony of Donald Phillips.)

would leave [184] it up to the Court to determine what was material to this case.

The Court: That was my understanding.

Mr. T. Baird: I'm sorry, your Honor. I did not realize that the work sheets of Mr. Phillips had been introduced in the other case.

Mr. Gardner: Is it agreeable to give this an identifying number?

Mr. T. Baird: Yes, have it a joint exhibit.

The Court: If it is going to be a joint exhibit, you might just as well mark it and put it in.

The Clerk: Joint Exhibit 21-XX admitted in evidence. Joint Exhibit 22-YY admitted in evidence. Joint Exhibit 23-ZZ admitted in evidence. Joint Exhibit 24-AAA admitted in evidence.

(The documents above referred to were marked Joint Exhibit 21-XX, 22-YY, 23-ZZ and 24-AAA for identification and received in evidence.)

Q. (By Mr. Gardner): Were the notices of deficiency issued to the petitioners in this case based on your report, Mr. Phillips?

A. So far as I know, yes.

Q. Does Schedule Q of that report show the manner of distribution of the corporation to the Petitioners?

A. Yes, it does. [185]

Q. I hand you Exhibit DD. This is a check to Gene Clark, Inc. from a Southern California investment company, and I ask you whether or not that check is shown in the records of the corporation?

A. This check was not.

(Testimony of Donald Phillips.)

Q. Was it recorded as a sale, Mr. Phillips?

A. No, sir, it was not.

Q. Was it deposited to the corporation bank account?

A. This check was not.

The Court: Do you have a long list of those, Mr. Gardner?

Mr. Gardner: Yes, sir.

The Court: Isn't it possible for counsel—you've got an agent to examine the books and an accountant here—isn't it possible to agree whether or not these checks were included in the records of Gene Clark or not?

Mr. T. Baird: It certainly is, your Honor.

Mr. Gardner: These items, your Honor, in connection with this item, there are several substitutions which we intend to bring out by this witness. Now, if he can just testify as to the——

The Court: Well, certainly you have a right to bring out the facts as to substitutions, but I mean, if it is going to take longer to arrange it than it is to hear it this way, then go ahead, but it does seem to me that groupings could be [186] made which counsel could stipulate and save a great deal of their time and a great deal in the record.

(Discussion between counsel.)

The Court: Gentlemen, if there is going to be an argument about it, go ahead. Proceed.

Q. (By Mr. Gardner): I hand you Exhibit EE——

Mr. A. Baird: If your Honor please, I think that we might save the Court's time if the Court

(Testimony of Donald Phillips.)

would give us above 10 or 15 minutes to confer here. Certainly there are some things about which there is no dispute; it is just a matter of reaching an agreement as to how it was handled.

The Court: Is there a disposition on the part of counsel to do this?

Mr. Gardner: Oh, no, your Honor, I am perfectly willing to stipulate anything.

The Court: You mean, "Oh, yes," I suppose, but we will take it as such. All right. I will retire and the Clerk can call me when you either have agreed to disagree or agree to agree and have determined what the terms of the agreement are.

(Recess.)

The Court: Proceed, gentlemen.

Q. (By Mr. Gardner): Mr. Phillips, you have before you Exhibits DD, EE, [187] GG, and Exhibit FF. You have previously stated that you examined the books and records of the corporation and, also, you examined the corporate returns and the individual income tax returns. Now, would you tell us just what happened to this check, according to your examination of those records?

A. This check was negotiated or cashed at Bell Gardens Bank and on the same date as the perforation date on this check, a cashier's check was issued which is Exhibit AA in the same amount.

In the records of Gene Clark, Inc. cash receipts 5491, 5492, 5493 and 5494, in the respective amounts of \$1,786.16, \$1,473.93, \$1,250 and \$2,099.91, were recorded as being received respectively from Gene

(Testimony of Donald Phillips.)

Clark, Story and Sons, Las Vegas Supply Company and Las Vegas Supply Company. The cashier's check was deposited in the Citizens National Bank, Maywood Branch, and included in a deposit dated March 31st, 1948, in the amount of \$12,816.85, and, included in my schedule of cash receipts unidentified as opposed to deposit items unidentified. That is where I have it located.

Q. What was the total amount of those cash receipts, Mr. Phillips? A. \$6,610.

Q. Did you discover that they were deposited?

A. The cash, only the cashier's check was the item of deposit. [188]

Q. Were any of the amounts shown on the cash receipts deposited?

A. Not as individual items, no, sir.

Q. How did the corporation report its income, Mr. Phillips? From deposits and cash receipts?

A. Well, their sales record is the record of income.

Q. You stated that the check in the amount of \$6,670 did not get into that record?

A. That's right, sir.

Mr. Gardner: May I have Exhibits LL and MM, please?

The Clerk: Those are the two checks, aren't they?

Mr. Gardner: Would you mark this for identification Respondent's next in order?

The Clerk: Is this one exhibit?



(Testimony of Donald Phillips.)

Mr. Gardner: Both of them, yes.

The Clerk: Respondent's Exhibit BBB marked for identification.

(The document above referred to was marked Respondent's Exhibit BBB for identification.)

Mr. T. Baird: We will stipulate to those.

Mr. Gardner: It is stipulated, if it please the Court, that Exhibits LL and MM, two checks, were not included in the records of Gene Clark, Inc., neither as a deposit or as a cash receipt, and also not included in the income. It is [189] also stipulated that—now, follow this closely—that a cash payment of \$12,000 testified to previously by Mr. Meissenburg was not included or not shown on the records of the corporation and was not included in income for the corporation.

Mr. T. Baird: That is correct.

The Court: All right, then, do you contend that either of the items just discussed were included in the personal income tax returns of Gene O. Clark and his wife?

Mr. T. Baird: I do not contend that, no, your Honor.

The Court: All right. If we are going to get into that, we might just as well know it while we are having these stipulations. Let's find out whether there is any such contention.

Mr. Gardner: That would be—will you stipulate to that, that it was not included?

The Court: He has already so stipulated.

Mr. T. Baird: I might add, your Honor, just so

(Testimony of Donald Phillips.)

the record will show that we are not admitting by that stipulation that that is the income to the taxpayers, but it may have been return of capital.

The Court: We are not admitting that it is capital. You are admitting that it was not included in income.

Mr. T. Baird: Yes, your Honor.

Mr. Gardner: Will you stipulate that the checks [190] entered in evidence, that is, from the Valley City Supply, were not shown on the books and records of the corporation?

(Discussion between counsel.)

Mr. Gardner: It is stipulated that the checks included in Exhibit AA are not included in income of the corporation and not shown on the books and records of the corporation.

The Court: It is further stipulated that they were not included in the income tax returns of the Petitioners?

Mr. T. Baird: It is, your Honor, with the same reservation.

The Court: Very well. I understand to each of these items that you are not admitting they are income.

Mr. T. Baird: That is correct.

Mr. Gardner: Will you stipulate——

(Discussion between counsel.)

Mr. T. Baird: So stipulated, Mr. Gardner.

Mr. Gardner: And this check?

(Discussion between counsel.)

Mr. T. Baird: So the record will show all of

(Testimony of Donald Phillips.)

these stipulations should read the same. I don't think we need to state it each time, your Honor, do we?

The Court: I don't see any need as long as it is identical with preceding ones. If there are any variations, you can bring them up. Otherwise, you can simply identify the items and say stipulated the same as previous items. [191]

Mr. Gardner: Exhibit CC, a check in the amount of \$2,294.50, payable to Gene Clark, from Mitchel & Son. It is stipulated that this amount was not shown on the books and records of the corporation, was not included as income for the corporation, and was not shown as income on the individual income tax returns.

Mr. T. Baird: So stipulated as before.

Mr. Gardner: Exhibit TT, a check in the amount of \$2,223, payable to Gene Clark Plumbing Company, same as the prior stipulation.

Mr. T. Baird: Agreed.

Mr. Gardner: May I have Exhibit SS, please?

The Clerk: Here it is.

Mr. Gardner: The same?

Mr. T. Baird: The same.

Mr. Gardner: Stipulated that Exhibit S, a check in the amount of \$1,158.44, the same conditions existing as to this check as in the preceding exhibits.

May I have Exhibits U, V and W, please?

Q. (By Mr. Gardner): Mr. Phillips, I hand you Exhibits V, U and X, and ask whether or not those



(Testimony of Donald Phillips.)

checks were recorded in sales for the corporation?

A. Exhibit U, a check, No. 15340, Hamilton Homes, Inc., was not recorded in sales or in cash receipts of Gene Clark, Inc., [192] but was included in the bank deposit of Gene Clark, Inc., dated September 16, 1947, in the amount of \$21,180.51. That check was in the amount of \$1,221.

Exhibit W, a check in the amount of \$2,295, No. 15390, Hamilton Homes, Inc., further, was not included in the sales record nor in the cash receipts records as such, but was deposited in the same deposit.

Check No.—Exhibit V, check No. 14760, Hamilton Homes, Inc., account in the amount of \$2,170 was not included in the sales records of Gene Clark, Inc., nor identified in cash receipts as such, but was in the Gene Clark, Inc. deposit dated July 30, 1947, in the amount of \$10,016.46.

Exhibit X, checks dated September 15, 1947, in the amount of \$1,000, and September 23rd, 1947, in the amount of \$224, drawn on the account of H. K. Niles, for \$1,000 was not included in the sales reported, nor was it identified as such in the cash receipts record, but was included in the September 16, 1947, deposit in the amount of \$21,180.51 of Gene Clark, Inc.

Q. As to the check for \$224, Mr. Phillips, I believe you will find that check was recorded.

Mr. T. Baird: I beg your pardon?

Mr. Gardner: The check in the amount of \$224 was recorded.

(Testimony of Donald Phillips.)

Mr. T. Baird: Are you willing to so stipulate?

Mr. Gardner: Yes, we will so stipulate.

Q. (By Mr. Gardner): I hand you Exhibit II, a cash receipt received from Gene Clark, \$8,241.42. In accordance with your investigation, did you discover any connection between this receipt and those checks that you recently referred to?

A. The cash receipt which reveals that an amount of \$8,241.42 was received from Gene Clark as an individual by Gene Clark Plumbing Company, although this was a regular cash receipt used by Gene Clark, Inc. In my schedule of substituted items, page 4 of nine, for the year ended April 30, 1948, reveals that within the deposit, dated September 16, 1947, in the amount of \$21,180.51, that a check in the amount of \$3,241.42, as a result of my investigation, was determined to have been drawn against the Gene Clark Plumbing account in the Bank of America, El Monte, was included in this deposit and, also, items as follows: Drawn on the California Bank, Bell office, Bell, a check in the amount of \$178.70; a check on the California Bank, Bell Office, Bell, in the amount of \$48.43. In the previous exhibits referred to of \$1,000 from H. K. Niles on his check No. 68, \$1,221 from the Hamilton Homes, check No. 1534 and \$2,295 from the Hamilton Homes, check No. 1539.

Q. Am I to understand, then, that the checks that you just now referred to were substituted for \$5,000 that Mr. Clark did not pay to the corporation

(Testimony of Donald Phillips.)

in connection with the [194] cash receipts in the amounts of——

Mr. T. Baird: Objected to as asking for a conclusion of the witness.

The Court: It isn't really a conclusion. What have you got to say about it?

Mr. Gardner: Well, the witness has testified that he did discover a check from Gene Clark Plumbing in the amount of \$3,241.42, leaving \$5,000 still to be accounted for, and he has testified that included in the deposit with these checks totaling approximately \$4,516.

I am asking him now if that was the result of a substitution.

Mr. T. Baird: Your Honor, I think the record speaks for itself, that he does not have to draw this conclusion. You can pick checks out of the air and say these were all substitutions for this one item.

Mr. Gardner: I am asking in accordance with the investigation.

The Court: Mr. Gardner, it seems to me that this witness was asked to determine a final analysis from circumstances. He has testified to all of the circumstances and I rather fancy that the final analysis has got to be made by me. I don't think it is too significant at this point because I think the analysis is perfectly clear, but there may be some objection to this witness theoretically taking my prerogative, [195] so I think I will sustain the objection as to the final question.

(Testimony of Donald Phillips.)

Mr. Gardner: I had no intention, your Honor, of usurping the Court's—

The Court: I am sure you didn't. You can ask him—he is here with his records and his calculations—you can ask him what he did and in connection with the calculation rather than the fact, as to what he concluded, which is something I will ultimately have to agree with or disagree with, so I will permit you to ask him. After all, he is testifying as to various calculations he made with respect to adjustments, and the Revenue agent's report, the statutory notice of deficiency in relation to the return on the books, and I will let him answer as to what he attributed it to for the purpose of the calculation.

Q. (By Mr. Gardner): For the purpose of your calculation, Mr. Phillips, what significance did you attach to the checks, three checks, previously mentioned, which I believe you testified were deposited but were not reported as a cash receipt?

Mr. T. Baird: Objected to for the same reason, your Honor.

The Court: I am going to overrule the objection. Answer the question. It is understood that I am amending the question with the modification that I made before, whether it [196] is clear or not, so answer the question.

The Witness: I added the checks into my exhibit for the fiscal year ended April 30, 1948 as unreported income determined from substituted items in

(Testimony of Donald Phillips.)

bank deposits. That exhibit is Exhibit J in my report.

The Court: All right, go ahead.

Q. (By Mr. Gardner): Mr. Phillips, in examining the books and records of the corporation, did you discover, during the year 1946, on or about February 5th of that year, a payment for income from one Y. L. Creed in the amount of approximately \$2,350.

A. Mr. Gardner, there were no records of the corporation prior to May 1st, 1946.

Q. Did you examine the records of the partnership for that time prior to the formation——

The Court: Better call it Clark Plumbing Company so that we don't get into an argument as to whether it was a partnership or not.

Mr. Gardner: Yes, your Honor.

Q. (By Mr. Gardner): ——Clark Plumbing Company prior to the formation?

The Court: Gene Clark Plumbing, I'm sorry.

Q. (By Mr. Gardner): Gene Clark Plumbing.

A. What was the amount? [197]

Q. It is approximately \$2,350.

A. Of unreported income from what customer?

Q. Y. L. Creed.

A. My only recollection of the item is the fact that \$544 was deposited to the account of Gene Clark Plumbing on February 5, 1946 and was reported in sales of that organization or company.

The Court: Does that mean that you found no



(Testimony of Donald Phillips.)

entry with respect to the difference between the two amounts?

The Witness: My report had an amount of \$3,602.50 of contract work performed for Y. L. Creed by Gene Clark on which Gene Clark was allowed the difference as a down payment on a house from Y. L. Creed.

The Court: All right.

Q. (By Mr. Gardner): Was the amount allowed as a down payment on a house from Y. L. Creed reported as income by Mr. Clark on his individual income tax return? A. No, sir.

Q. Did it show on the records of the Gene Clark Plumbing Company? A. No, sir.

Mr. Gardner: No further questions.

### Cross Examination

[198]

Q. (By Mr. T. Baird): Mr. Phillips, speaking of the Y. L. Creed transaction, will you state over again to me how you treated that transaction in your report?

A. The total amount of \$3,602.50 plumbing contracts for work performed on four houses for Y. L. Creed, only an amount of \$544 was deposited to the account of Gene Clark Plumbing on February 5th, 1946 and was reported in the prior organization's sales. The remainder was allowed as a credit outside escrow and I added it to income of the corporation.

Q. Income of whom or what?

A. It is Gene Clark, Inc.

(Testimony of Donald Phillips.)

Q. Why Gene Clark, Inc.?

A. I believe the transaction of the sale of the house was after incorporation.

Q. Didn't you realize that all of the transactions occurred prior to incorporation?

A. I don't believe they did. If they did, then I must have made an error in my report.

Q. Well, did you adjust the cost basis later on in your report when Mr. Clark sold the house, Mr. Phillips?

A. I don't—

Q. 1947, to be exact, when he sold the house?

A. I don't know offhand if he reported a gain or not, but if he reported no gain, I didn't do anything because the loss would have not been deductible. [199]

Q. He reported a gain. It is on his tax return, Mr. Phillips. Did you increase his basis?

A. I do not know, sir. I would have to see the report.

Mr. T. Baird: May I have the tax return for 1947, Gene Clark?

While we are looking for this, Mr. Phillips, will you look at your report and show where you adjusted the basis, if you did, in 1947?

\* \* \* \* \*

The Witness: Thank you.

Would this be the sale of the residence in June of 1947?

Q. (By Mr. T. Baird): Yes, it would.

A. From my report, it appears that I allowed \$708.50 of cost outside of escrow. To the best of my

(Testimony of Donald Phillips.)

recollection, the reason that I allowed no more was that of the \$8,500 cost basis claimed, all that I was able to substantiate would have been [200] the difference between—that was paid out of costs outside of escrow, would have been the difference between the \$3,058.50, which I added to income in the Gene Clark, Inc. case and the \$708.50 which I allowed here.

Q. You mean to say, Mr. Phillips, that you allowed the same figure that you used as a fictitious profit to Mr. Clark in 1946, you carried on through to raise his basis when he sold it in 1947?

A. Mr. Baird, I said that he claimed a cost basis of \$8,500.

\* \* \* \* \*

The Witness: The cost basis claimed on this home was \$8,500 in the return, evidently. All that I could verify as having been paid through escrow was an amount less than \$8,500 and, therefore, instead of allowing the entire \$3,058, which I had added in the Gene Clark, Inc. case, I only allowed \$708.50, and used the remainder of that figure, or approximately \$2,300, as being part of the cost basis of \$8,500 which he claimed.

Q. (By Mr. T. Baird): So you added more into income in the Gene Clark income in the fiscal year '47 than you added to the base?

A. No, sir. [201]

The Court: That is not what I understood him to say.



(Testimony of Donald Phillips.)

Mr. T. Baird: I am sorry, your Honor. I am not getting——

The Court: If I can try to explain it my way, let the witness correct me if I am wrong, he says that the taxpayer used a basis which he couldn't verify and to the extent that he couldn't verify it he supplied it in part with some of this \$3,000 odd dollars, bringing it up to the basis that the taxpayer did claim, to which he added \$700-some dollars that he hadn't exhausted in the process.

Now, is that correct or not?

The Witness: That is correct.

The Court: So, according to his testimony, he allowed the full amount to increase the base after first having reduced the base by an amount which he couldn't verify.

Q. (By Mr. T. Baird): Did you ever consult Mr. Gene Clark about the base to see if you could get any verification?

A. I never talked to Gene Clark during the entire course of my investigation.

Q. I would like to refer you now, Mr. Phillips, to Exhibit Q of your report. Reading down Exhibit Q to sub E thereof, I see—have you got that so far? I don't want to go ahead.

A. All right. [202]

Q. You have that entitled Total Distributions Per RAR, \$74,984.96. Then, reading over to the right under Gene Clark, you have the years 1946 and 1947, and you, apparently, have broken up the amounts of \$74,984.96 into two amounts and you

(Testimony of Donald Phillips.)

have allocated one amount to 1946 and another to 1947. Will you tell the Court how you arrived at that allocation for each year?

A. As far as I can remember at this time, it was based upon the stock ownership of 30-70, and for each year on the amounts available to be applied as constructive dividends.

Q. Well, how did you know what the amount available for 1946 was? How did you arrive at the figure \$44,237.13?

A. I don't seem to have the computation here of how that is done, sir, but this point has been belabored so much that all I can say is that I did it on a stock ownership basis and I do not recall at this time.

Q. Well, I realize that you attributed 70 per cent of the profits to Mr. Clark and 30 per cent to Mr. Koyl. That has been already gone into, but I am asking you, this first year, you realize, do you not, that the fiscal year ended April 30, 1947?

A. I do, sir.

Q. Well, how could you have had any amount available for distribution in 1946 when the taxpayers were on a calendar year basis? [203]

A. Well, if this had been a partnership, I would believe that when the period ended that this would be when I would have distributed it, but it was a corporation, and the moneys were taken outside the records of the corporation and, therefore, I distributed them as they got them, on a cash basis to the

(Testimony of Donald Phillips.)

individuals, as they got them or as they were made available to them.

Q. Then you can show me that \$44,227.13 was either received or made available to them in 1946?

A. Only that it was available to them.

Q. How?

A. By the computation of the adjustments to net income in my report, plus the Kansas farms, and less the accounting adjustments to net income I made that I said were not available.

Q. We will go on now, Mr. Phillips. I believe that you testified in prior testimony, which is a part of this record, that you took income taxes or income taxes and corporation taxes in this case into consideration when you reached a figure of total distribution. Where on Schedule Q can you show me that income taxes was taken into consideration?

A. We would have to go to one of the other exhibits, Exhibit D, analysis of surplus.

Q. What page is that, Mr. Phillips, and will you show there the amount of income taxes that you took into consideration? [204]

A. \$43,885.88.

Q. Well, Mr. Phillips, look to Schedule 1 of your report, statements of total tax liability. Haven't you got down there total income tax liability is \$50,419.26?

A. I do, sir.

Q. Well, how do you account for the difference?

A. At this time, I can't, sir.

Q. All right, well, let's go on, let's go back to Schedule Q. To recapitulate, your Schedule Q does

(Testimony of Donald Phillips.)

not take income taxes into account at all, is that correct, Mr. Phillips?

A. No, sir, but only in amount available from the adjustments in my report.

Q. You have stated in previous testimony that you made certain adjustments to the amount that is available for distribution. I am now referring to Schedule Q and also your explanation on Schedule Q-1. Are those the adjustments that you took into consideration? A. Yes, sir.

Q. In determining distributable net income for the fiscal year 1947? A. Yes, sir.

Q. Let's refer back to your Schedule D on page 58, Mr. Phillips. Where on that schedule can you show me that those items shown on Q-1 of your report and on Schedule Q of your report were taken into consideration in analysis of surplus on [205] Schedule D, other than merchandise purchases? A. They aren't, sir.

Q. Why not?

A. I don't think that it is necessary.

Q. Didn't you just state that you made certain adjustments to arrive at income available for distribution? A. Yes, sir.

Q. And now you are saying that you didn't think it was necessary when you made up this exhibit?

A. This is a statement of the surplus account as such. The additions for the year were \$132,000, and out of the \$132,000, after taking away the \$74,000 and, in this case, \$43,000 income taxes and \$2,700

(Testimony of Donald Phillips.)

of merchandise purchases, there is still a remainder of \$11,000 surplus, \$11,097.01 of earned surplus still available.

Q. In other words, you didn't take them into consideration in final analysis, is that correct? On Q-1, you said you were taking them into consideration, did you not? I refer to D on Schedule Q-1. You state adjustments to net income not available, \$63,488.47.

A. Oh, possibly the wording is not correct, but that was used as a reduction from the total amount of the constructive dividends.

Q. Do you really believe that was used as a reduction and carried through to the 90-day letter, Mr. Phillips? [206]

A. Yes, sir.

Q. You believe that \$63,000 was subtracted from the \$102,000?

A. I didn't say that it was subtracted from \$102,000.

Q. Well, I am referring now back to Schedule Q.

A. I said that it was a reduction of the amount on Schedule Q, arrived at by using the adjustments to net income and the items A, B, and C, other investments, notes receivable, a total of \$138,473.43.

The Court: Mr. Baird, at this point we will recess until five after four.

(Short recess.)

Q. (By Mr. T. Baird): Mr. Phillips, did you prepare balance sheets for each of the years involved for this corporation?



(Testimony of Donald Phillips.)

A. You mean amended balance sheets to conform with my report?

Q. Yes.           A. No, sir.

Q. Why didn't you?

A. I was not required to by my findings.

Q. Well, if you had, would you not have taken into consideration the items listed in Schedule Q and Q-1 in arriving at adjusted figure as to what was available for distribution, a figure somewhat less than on Exhibit D of your report? [207]

A. No, sir.

Q. You wouldn't? How would you have treated it in your balance sheet, those items in Exhibit Q-1 if you had prepared one? You know what items I am referring to?

A. Not offhand now, I don't know what you are referring to.

Q. I am referring to the items Truman Johnson, H. L. Brittain, deferred income, bad debts, and an item you have marked "All Items with Exception of \$200 Check to Archie Koyl," \$2,714. Do you see where I am reading?

A. Yes, you better rephrase it or go over it again, I am sorry.

Q. If you had made a balance sheet, would you have treated those items in that balance sheet as not being available for distribution? Would you have reduced your surplus by those amounts?

A. No, sir, I would not.

Q. Why?

A. They are not adjustments to the surplus

(Testimony of Donald Phillips.)

account itself. The adjustments to the surplus account are made on Schedule D.

Q. Wouldn't you have set up a reserve on the liability side of your balance sheet for these items?

A. Well, for example, deferred income item is a reserve on the books. [208]

Q. And in the fiscal year 1947, if that is a reserve on the liability side of the balance sheet, then it is not available for distribution, is it?

A. In my report, I reversed that. On a balance sheet, it would no longer have been a reserve.

Q. Don't you set that aside in Exhibit Q as a reserve?

A. I only used it as a reduction for the amount available for dividends.

Q. You did that on Exhibit Q but did you do that on Exhibit D?

A. No, sir, as I explained, sir, that is no entry in the surplus account as such and the Exhibit D is only the surplus account as amended.

Q. Well, let's get away from Exhibit D, then. Let's talk in general. Referring to the 90-day letter, and it has been stipulated that the 90-day letter is based on the Revenue Agent's report, have you looked at the 90-day letter, Mr. Phillips?

A. Just, oh, cursory examination.

Q. Have you had any time to look at it?

A. Yes.

Q. Do you believe that this account in Q-1 that we have been talking about has been taken into account when arriving at that figure in the 90-day

(Testimony of Donald Phillips.)

letter? A. Yes, sir, I do believe so. [209]

Mr. Gardner: May I inquire, are we talking about the corporate 90-day letter or the individual?

Mr. T. Baird: One is dependent upon the other, Mr. Gardner. I will include both of them in that statement.

Q. (By Mr. T. Baird): Well, going ahead, Exhibit Q, you treated the amount \$49,210.15, the deferred income item, as not available for distribution on Exhibit Q and Q-1. Isn't that what you have entitled it? A. Yes, sir, that is true.

Q. Well, what did you do with that item? Did you use it as an item available for distribution in any year?

A. As I mentioned, I only used it as a limitation, an item that I reduced the total amount available for dividend distribution.

Q. In what year?

A. The year ended April 30, 1947.

Q. You say that you reduced the amount available for distribution by \$49,210? A. Yes, sir.

Q. Did the corporation report this item as income in the year 1948, in the fiscal year 1948?

A. Well, not that item as such, but by—

Q. By total amount?

A. Method of income reporting that they were using, that [210] amount came into income in the following year, the subsequent year ended April 30, 1948.

Q. What year did you treat the \$49,000 deferred income item as available for distribution?



(Testimony of Donald Phillips.)

A. In the following year, when I used it to increase. It is included in the adjustments to net income, really.

Q. And then, it was, as far as you can see now, from your schedule, it was not taken into consideration in 1947 as reduction of surplus available in '47, is that correct?

A. It is not a reduction of surplus available but only a reduction of the figure that I used of \$138,000 of moneys available, moneys or properties or other things available for distribution.

Q. Did you know, Mr. Phillips, that figure \$49,000 and all the rest of the figures therein were in fact used twice as income available for distribution? What I mean by that, in the year 1947 and in the year 1948, the same items and, as reflected in the 90-day letters which are based on the Revenue Agent's report. Did you know that fact?

A. I do not know it now, sir.

Mr. T. Baird: That is all.

The Court: I am sorry, you said something I couldn't hear.

Mr. T. Baird: That is all.

The Court: Very well. [211]

\* \* \* \* \*

Q. (By Mr. T. Baird): Did you attempt to make any net worth—take a net worth statement or a calculation of Gene Clark or Faye Clark?

A. Do you mean at any time during the investigation?

Q. Yes.

(Testimony of Donald Phillips.)

A. I believe at some time during the investigation we attempted to make up some net worth sheets, balance sheets.

Q. Have you those sheets with you?

A. No, sir.

Q. Are they available?

A. They were never a part of my work papers as such.

Q. Well, as a result of your attempts, what conclusions did you arrive at in regard to the net worth of these petitioners?

A. You just want an opinion?

Q. Yes.

A. That during some of the years, that he had far greater increases than his net worth, than he had reported on his tax return. [212]

Q. Well, did you specifically trace any of these items to Mr. Clark's individual bank account?

A. The unreported items of income of the corporation?

Q. That are included in your report on the corporation.

A. Well, to the Gene Clark Plumbing account and the Bank of America——

Q. Well, aside from Gene Clark, Inc. and Gene Clark Plumbing, any other bank accounts?

A. I didn't personally trace them. I had the records of some of the bank accounts in Independence, Kansas where some of the unreported items finally had gone to.

(Testimony of Donald Phillips.)

Q. Those banks accounts being set up for the farm proposition back there?

A. I don't know why they were set up, sir.

Q. Did you trace any of these moneys to Mr. Gene Clark directly or his wife or for their enjoinderment?

A. I can't remember any specific ones, but I am sure that there were some that they received. [213]

\* \* \* \* \*

### GENE O. CLARK

was called as a witness by and on behalf of the petitioners and, having been first duly sworn, was examined and testified as follows:

\* \* \* \* \*

### Direct Examination

Q. (By Mr. A. Baird): Mr. Clark, will you state where you were born, please?

A. At Independence, Kansas.

Q. And will you tell us, please, by way of introduction, something about your educational experience? [215]

A. Yes, I had two years of high school.

Q. And that was at what place?

A. At Independence, Kansas.

Q. You graduated from high school about when?

A. I did not graduate, I had two years.

Q. I mean the two years. You terminated your association with high school, shall we say?

A. About '27.

Q. After leaving high school, Mr. Clark, in what occupation or business did you engage?

(Testimony of Gene O. Clark.)

A. Quite a lot of different things. I worked for the Perry Pipeline Company, Sears Roebuck, and numerous odd jobs around a small town, and then I went into the plumbing business.

Q. Had your father before you been engaged in the plumbing business?

A. Yes, Dad was a plumber before I was born and still is.

Q. And he still resides where?

A. At Elk City, Kansas.

Q. You say that you went into the plumbing business. Did you go into the plumbing business in Kansas?

A. No, sir, I went into the plumbing business in Maywood, California.

Q. What time? A. 1939.

Q. 1939? [216] A. '39.

Q. Was it necessary for you to apply for and obtain a license or permit to work as a plumber in California at that time?

A. Yes, it is necessary to pass a master's plumbing license in order to contract and, of course, that's what I did. That is, in fact, running a business, and I passed that examination.

Q. And have you held that license under the State of California ever since?

A. Yes, in numerous cities.

Q. In other words, it is necessary to get licenses in the various cities as well as have a State license?

A. That is correct.

(Testimony of Gene O. Clark.)

Q. How long did you operate your plumbing establishment in Maywood, California?

A. I was only there a short time, some few months, and we moved to a larger and better location at Huntington Park.

Q. And how long did you engage in the plumbing business at that place?

A. We ran a plumbing shop there up and until some time in '41, and it ran, I think, even into '42, even though I was, myself, personally at Las Vegas.

Q. In 1941 and just prior to the time that you went to Las Vegas, how large an operation did you have? [217]

A. I was of the opinion we ran 50 some-odd men, but some of my employees tell me we ran a little more than that because of the floor furnaces or the heating crews, so I would say it varies between 50 and 75 men.

Q. Then, as I understand you, in 1941, you left and went to Las Vegas, Nevada?

A. That's correct.

Q. And did you continue your business here in Los Angeles County?

A. Yes, I left the foreman in charge to finish up all of our contracts here and as he finished them, then he could bring the crews and trucks and et cetera up to Las Vegas.

Q. Now, what particular type of plumbing business did you engage in?

A. I have always did contracting plumbing, that



(Testimony of Gene O. Clark.)

is to say, we take a contract to do a job at a given price.

Q. As a part of your operation, were you engaged in the business of selling plumbing supplies and materials? Was that a main part of your operation?

A. It was never our main part, no, sir.

Q. Now, what type of business did you engage in when you went to Las Vegas?

A. At Las Vegas, I did plumbing contracting. As a matter of fact, I had a contract of some 74 houses to start on which was one reason of going there. Almost immediately upon [218] my arrival, I built a building, and we also opened the Nevada Plumbing Supply, that is plumbing supplies wholesale, sales to the plumbers. Then, I, unfortunately, posted a bond for a contractor and it appeared at the first of the job as though he couldn't or wouldn't complete it, so I automatically went into the general contracting business.

Q. Well, Mr. Clark, you said that you posted a bond. What was the nature of the bond and what was the amount?

A. A Mr. Ralph Saunders had signed a contract——

\* \* \* \* \*

The Witness: Mr. Saunders couldn't post a bond, which was some \$189,000, so they called me in primarily to post the bond and be the general contractor, which I did.

Q. (By Mr. A. Baird): You put up a bond—you

(Testimony of Gene O. Clark.)

were required to put up a bond for what amount?

A. I believe it was \$189,000.

Q. Did you complete that contract?

A. Yes, sir.

Q. How long did you remain in Las Vegas?

A. A little over a year. [219]

Q. Then what did you do?

A. We went to Provo, Utah and did a housing job for the Geneva Steel employees, that is I did it for Dr. Shipley Nelson of 92 houses.

Q. 92 houses? A. Yes, sir.

Q. During any of this period of time to which you have referred, were you associated with Archie Koyl? A. No, sir.

Q. After you had completed your contracting work in Provo, Utah, you returned to California, did you not? A. That's correct.

Q. Will you tell us about when that occurred?

A. It was in the latter part of '43 or the first of '44.

Q. And under what name or designation did you operate in California?

A. Gene Clark Plumbing.

Q. And at that time, in 1944, were you the sole owner of Gene Clark Plumbing? A. Yes, sir.

Q. At some point at or about that time or shortly thereafter, you entered into some sort of an arrangement with one Archie Koyl, did you not?

A. That's correct.

Q. Can you tell us about when that occurred?

A. It was in 1944, I believe, at the latter part.

(Testimony of Gene O. Clark.)

Q. The latter part of 1944? A. Yes, sir.

Q. Now, before I get into that, may I ask you, when you came from Utah, did you bring with you any plumbing supplies, materials, or things of that kind? A. Not when I came from Utah.

Q. Well, what disposition, if any, did you make of supplies that you may have had when you left Las Vegas?

A. I liquidated or turned into cash most of the assets that I had, which included the plumbing shop, trucks, tools and equipment, the Nevada Plumbing Supply, a building, and lots, and construction equipment, et cetera. I turned most of that to cash.

Q. You stated that you formed some sort of a business arrangement with Archie Koyl. Can you tell us how that occurred and what the arrangement was?

A. Yes, one of the boys from Las Vegas, one of the plumbers and I were doing a very nice business. As a matter of fact, it was growing so rapidly that we needed help tremendously, and Archie had from time to time asked me if I knew where he could get into a business rather than work for a larger company, and I think one day we were doing something and he said what would it take to get in the plumbing business with you, and I said, "Well, just how much do you want? How much do you have?" [221] and he said, "\$1,500," and I said, "I tell you what, I will give

(Testimony of Gene O. Clark.)

you 30 per cent of the profits or a salary and we will just do it.”

Q. Was Mr. Koyl a licensed plumber?

A. No, sir.

Q. Had he ever had any experience, to your knowledge, in the plumbing business?

A. I doubt it.

Q. Well, had you known Mr. Koyl prior to this meeting that you are telling us about?

A. Yes, we went to school together through the first grade.

Q. Back in Kansas?                      A. That's correct.

Q. I take it then that you have been intermittently in contact with one another, favorably and otherwise, ever since you left the first grade down to the present time?                      A. That's correct.

Q. Can you fix the date as near as you can—I think it is in the records, but just for my own information—as to when Mr. Koyl came with you and when you started this business arrangement to which you have just referred?

Well, Mr. Clark, it isn't necessary to be precise about it. I am just trying to be——

A. I had believed it to be about October, 1944.

Q. What did you have Mr. Koyl do when he became associated with you?

A. Well, he, naturally, didn't know plumbing supplies and, actually, what I needed was somebody to do the purchasing which—it is a very tedious job and takes a lot of time. That is, at that time you needed to drive a truck all day and

(Testimony of Gene O. Clark.)

pick up what you could where you could, so I attempted to show him the difference between pipes and fittings and so forth. So, I went with him for some weeks and finally, of course, he learned to do his own purchasing or recognize what he needed to buy, and after that time he did most all of the purchasing for both the plumbing and the corporation, the Gene Clark Plumbing and the Gene Clark, Inc.

Q. What was the particular type of plumbing business that you were doing at that time? Were you still contracting or were you engaged in distributing plumbing supplies?

A. We were doing mostly contracting but quite a lot of heating at that time.

Q. Quite a lot of heating? A. Yes, sir.

Q. I assume you mean by that you were installing furnaces? A. Yes, sir.

Q. Equipment of that kind?

A. That's correct. [223]

Q. And was that installation for private homes or industrial buildings or what?

A. Private homes.

Q. Coming down to some time in the early part of 1946, Mr. Koyl was still with you. Did you determine to make a change in your mode of operation?

A. Yes, we had decided to form a corporation. That was early in '46.

Q. And that corporation was actually incorpo-



(Testimony of Gene O. Clark.)

rated on or about the 1st of May, 1946, was it not?

A. That's correct.

Q. At the time that you formed this corporation, how large an establishment did you have? How many plumbers did you have working for you? What volume of business were you doing?

A. At the time the corporation was formed, we were running both El Monte and Bell Gardens. I would judge possible 35 plumbers.

Q. That's in both shops? A. Yes, sir.

Q. Can you give any estimate from your experience in this business, Mr. Clark, as to how much of an investment you need to run a shop of that size where you have 30 or 35 plumbers?

A. Yes. At this time of 1946?

Q. Yes. [224]

\* \* \* \* \*

The Witness: Under the circumstances, at the time we believed that in order to run a shop and pay the bills promptly, we believed it should be variable from \$4,500 to \$5,000 per man.

Q. (By Mr. A. Baird): When you formed this corporation, the record shows that it was incorporated for some \$50,200. That is correct, is it not?

A. That's correct.

Q. What went to make up the \$50,200 worth of capital that went into that corporation?

A. Well, number one, Mr. Cloud, the attorney, informed us that we should make available assets for this amount. So we knew, of course, we needed all of the trucks and we needed the pipe machines

(Testimony of Gene O. Clark.)

and the necessary things to run the shop, so we made an itemized list of those. Then, of course, the balance that was left, we made up of plumbing supplies as an inventory.

Q. Well, did you have any excess of plumbing supplies, inventories, material, and so forth, on hand on May 1st over and above the amount that was placed into the inventory of the [225] new corporation, Gene Clark, Inc.?      A. We did.

Q. You did. Can you give us any estimate as to how much of an inventory you had or, may I ask, do you have any record of the amount of inventory?      A. I do not have a record.

Q. Did you have any record?

A. I did have a record.

Q. Well, is it available now?

A. It is not.

Q. What happened to it?

A. That record, as well as my other personal records in 1948 or the first part of 1949, a Mr. Earl Stutzman of the Internal Revenue came out to El Monte and requested to check my returns for the years of 1946, '7, and '8. He approached Mr. Koyl first and finally Mr. Koyl brought him to me, and he requested to check these returns and I, of course, asked him to come in and we'd give him the necessary records that he asked for.

He came to the shop and I don't think on that trip we did too much. However, for several trips later, I took records as he would request them, which was my tax returns and paid bills and so

(Testimony of Gene O. Clark.)

forth, and I took them to his house. When he finished checking me, which was some 90 days later and I had at that time left the corporation and I was actually waiting to go to [226] Kansas, but I stayed 90 days waiting for him to finish my book work, and when he finished it I promptly left the next morning for Kansas. So, naturally, I didn't get any of the records back, and at this time I don't know where they are. [227]

\* \* \* \* \*

Q. (By Mr. A. Baird): Mr. Clark, going back to the time that Mr. Stutzman first called upon you, will you tell me, please, what he asked of you in the way of records or data or information?

A. Yes, he asked for all of my personal records for the years of '46, '7 and '8.

Q. Was his interrogation or investigation limited to you individually or did it involve Gene Clark, Inc., as well?

A. It was me individually. [229]

\* \* \* \* \*

Q. (By Mr. A. Baird): Mr. Clark, I will ask you whether or not he didn't indicate to you that his investigation was prompted by some informant's report? A. That's correct.

Q. Did you give him at that time the records that you had then available and for which he made a request? A. Yes.

Mr. Machtinger: Would you identify what records, now? Are these still personal records?

(Testimony of Gene O. Clark.)

Mr. A. Baird: Personal records, all personal records. [230]

Q. (By Mr. A. Baird): Then, as I understand you, from time to time he would make inquiry for something else, and you furnished that?

A. Yes, sir.

Q. Getting back now to the time of your—immediately preceding the incorporation of Gene Clark, Inc., you operated under the term of Gene Clark Plumbing, did you not? A. Yes, sir.

Q. Had you filed any certificate for doing business under a fictitious name or had you filed any partnership certificate showing that Mr. Koyl had any interest in this business? A. No, sir.

Q. Did you have any difficulty or any unpleasantness, disputes or controversies with Mr. Koyl with reference to the percentage and distribution of profits of this enterprise?

A. Not at that time.

Q. Well, leading up to the time of the corporation, forming of the corporation, had there been any discussions and any arguments as to the handling of funds or the distribution of profits?

A. Yes.

Q. Had Mr. Koyl made any statements to you that he was dissatisfied with the arrangement and wanted a larger percentage?

A. Yes, he felt he should have 50 per cent. [231]

Q. As a matter of fact, Mr. Clark, isn't it true that on your 1946 and your 1945 income tax returns that you reported a distribution of profits showing

(Testimony of Gene O. Clark.)

that you got 50 per cent and that Mr. Koyl got 50 per cent?      A. Yes, sir.

Q. However, when you formed the corporation, what percentage arrangement did you finally agree upon?      A. 70-30.

Q. And you obtained 70 per cent of the stock and he obtained 30 per cent of the stock?

A. That's correct.

Q. It is true, is it not, that on your individual returns which are in evidence for the year 1945 or for the year 1946 in particular, that you reported a certain amount of income from Gene Clark, Inc. and a substantial amount of income from another business which I assume was Gene Clark Plumbing?      A. That's correct.

Q. Did the fact that you were having some difficulty with Mr. Koyl have anything to do with your determination to form a corporation?

A. Yes, it did.

Q. Did you have any consultation with your lawyer, Mr. Cloud, about that?      A. Yes, sir.

Q. Had you ever been engaged before in business under a [232] corporate form, Mr. Clark?

A. No, sir.

Q. This is the only corporation experience, then, that you have had, as I understand it?

A. That's right.

Q. Will you tell us generally what the conditions were with reference to the availability of materials and supplies for the carrying on of the



(Testimony of Gene O. Clark.)

contracting plumbing business during the years 1945, '46, and well, let's say, '47?

A. It was very hard to obtain materials.

Q. And were there some Governmental restrictions on the amount of materials that you could obtain and the prices that you could pay?

A. There was, of course, price control.

Q. By that, do you mean priorities, or do you mean OPA?

A. There was both.

Q. Mr. Clark, will you state whether or not you found it necessary in order to continue with your business to make some deals with people from whom you sought to obtain supplies wherein you were required to pay cash?

A. There was many of that type of deals.

Q. And would those deals entail a situation where a regulation price was billed to your company and then an additional amount was paid in cash?

A. Yes, sir. [233]

Q. There has been some testimony here to the effect that a rather substantial amount of transactions of that kind occurred between your company and some concern down in Tyler, Texas. Will you tell us, please, when you first started doing business with this concern at Tyler, Texas and what was the name of that firm?

A. That is the Tyler Foundries at Tyler, Texas.

Q. Tyler Foundries?

A. Yes, sir.

Q. Who was the president and principal executive officer with whom you had your dealings?

(Testimony of Gene O. Clark.)

A. I am not sure, but I did business with Mike Harvey or a Mr. Heller, his assistant.

Q. You don't know whether he was the president or what, but he was the man with whom you dealt?

A. Yes, sir.

Q. Were your deals there rather extensive or somewhat—were your dealings there rather extensive or somewhat limited?

A. They were rather extensive.

Q. And did they cover the period 1945, '6, '7, maybe later?

A. Well, they covered '46, '7, and into '48.

Q. Why was it necessary for you to go way down to Tyler, Texas in order to get material?

A. That was the only foundry that we found in the United [234] States where we could buy materials.

Q. What particular type of plumbing material were you getting from that foundry?

A. Principally soil pipe.

Q. Principally soil pipe?

A. Yes, sir.

Q. And can you tell us what the arrangement was that you worked out with the gentlemen at Tyler, Texas?

A. Yes. If he sold us a carload of soil pipe, we, in turn, would pay \$300 in addition to his bill of lading in cash—or \$3,000.

Q. \$3,000?

A. Yes, sir.

Q. And how did that \$3,000 compare to the regulation price for which he billed your company?

A. Very close to double.

(Testimony of Gene O. Clark.)

Q. If I understand you correctly, if the quantity of soil pipe that you were obtaining in a particular transaction was billed to your company at \$3,000, are we to understand that you would pay an additional \$3,000 cash? A. Yes, sir.

Q. Did the amount of cash that you had to pay in these transactions vary from time to time?

A. I believe they were all the same. [235]

\* \* \* \* \*

Q. Do you have any record or did you have any record of the amount of cash payments that you made in these transactions that you had with this concern down at Tyler, Texas?

A. I had a record.

Q. Do you have that record now?

A. No, sir.

Q. Well, is that one of the records which you—to which you have referred in the Stutzman situation? A. Yes, sir.

Q. Can you give us any estimate, Mr. Clark, as to the amount of cash which you paid with reference to these [236] transactions involving Mr. Heller or Mr. Mike Harvey of Tyler, Texas?

A. I believe it to be variable between \$25,000 and \$30,000.

Q. That was cash that was paid for material which your company was purchasing in addition to the invoice price for which you were billed?

A. That's correct.

Q. Do you know whether or not Mr. Files, your office manager and the controller, and later, treas-

(Testimony of Gene O. Clark.)

urer, knew of the amount of cash that you were paying on these transactions or made any record of that in his books?

A. I am sure he didn't make a record in his books and I rather doubt that he knew any amounts.

Q. You heard his testimony this morning that he was generally familiar with the fact that this procedure was being carried on? A. Yes, sir.

Q. Mr. Clark, will you please tell the Court from what source did you get the money to make these cash payments to which you have referred and if there was more than one source we want to know that.

A. The source was by making sales of materials for cash or for checks and turning them to cash. That is the only source. [237]

Q. You have heard the testimony of Mr. Files in the Koyl case and in your own case this morning to the effect that you would sometimes come to him with checks and ask him to cash those checks and he would cash them out of the amount of money in the safe or in the cashbox or wherever you kept it in your office. A. That's correct.

Q. His statement in that regard is substantially correct? A. Yes, sir.

Q. And will you state whether or not that was one of the sources of money? A. Yes, sir.

Q. Which you used to make the payments to the people down in Texas? A. Yes, sir.

Q. You heard, did you not, Mr. Files' statement that there was no record made on the books

(Testimony of Gene O. Clark.)

of the company of these cash payments made for materials which your company had to have?

A. Yes, I did.

Q. And I take it that you are in agreement with his statement in that regard? A. I am.

\* \* \* \* \* [238]

Q. Directing your attention to the very beginning of the corporation, will you state for the information of the [239] Court whether or not you made any segregation of inventory and supplies as between the corporation on the one hand and the Gene Clark Plumbing on the other?

A. Originally, I separated them.

Q. And will you tell us what you mean by separating them? Did you have them in different yards or were they all in the same yard, same place, or what?

A. No, sir, the inventory I set aside for the corporation was in the Bell Gardens shop only. We set it aside to see if we could run the Bell Gardens shop on that inventory. The thing happened that you would expect and I expected it, the plumbers simply get in either part.

Q. I didn't quite hear.

A. The plumbers use out of either side, so actually the inventory got intermingled.

Q. Well, it is true, is it not, in the relatively short space of time the inventories were intermingled so there was no physical separation?

A. That's correct.

Q. Mr. Clark, in connection with the business



(Testimony of Gene O. Clark.)

that Gene Clark Plumbing was doing during the period after the corporation had been formed, did Gene Clark Plumbing as such have a license to operate as a plumbing contractor? A. No, sir.

Q. What had happened to Gene Clark Plumbing license? [240]

A. That license was, of course, taken into the corporation so that the corporation would have a license to do contracting.

Q. Are we to understand that the license is transferable?

A. To a corporation if the licensee is an officer.

Q. That is if an officer of the corporation is a licensee of the State? A. That's correct.

Q. Were you the only officer who could qualify in that respect? A. That's right.

Q. Koyl had no license? A. That's right.

Q. Now, then, did Gene Clark Plumbing then engage in contracting without any license?

A. No, sir.

Q. Did it do any contracting? A. No, sir.

Q. Did you do anything which you attributed to Gene Clark Plumbing other than to sell some material or trade some materials?

A. Nothing at all.

Q. Keeping in mind the period of time and your statement that materials were very scarce and hard to get, I will ask you whether or not it was necessary on more or less frequent [241] occasions for you to engage in trading and bartering with other plumbing concerns in order to obtain from them

(Testimony of Gene O. Clark.)

certain parts or material which they had which you needed in exchange for some different parts or material which you had and which they wanted?

A. I did some and Mr. Koyl did more, I believe, than I did.

Q. Do you know whether or not those transactions where there was simply a trading of materials of one kind for materials of another, were those transactions recorded on the books, or do you know? I am not sure that you know.

Mr. Machtinger: Would the reporter please read that question?

(Question read.)

The Witness: I don't believe they would be.

Q. (By Mr. A. Baird): Mr. Clark, did you pay any particular attention to the matter of book-keeping for auditing your concern?

A. No, sir.

Q. Have you had any experience or do you know anything about the matter of keeping books and auditing the books of the concern?

A. No, sir.

Q. Do you leave that more or less entirely to your auditor, Mr. Files? A. Yes, sir. [242]

Q. Mr. Clark, there has been some testimony here—well, I will withdraw that.

Before I forget it, my questioning with reference to cash payments to which you have referred has been more or less limited to transactions down in Texas. I would like to ask you whether or not your company engaged in somewhat similar trans-

(Testimony of Gene O. Clark.)

actions with other concerns elsewhere in the country?

A. Yes, sir.

Q. And did you engage in any such similar arrangements with any concerns in Los Angeles?

A. Yes, sir.

Q. You have heard some testimony here with reference to some sort of an arrangement that was worked out between Gene Clark, Inc. and the Keenan Pipe and Supply, I believe it was. Are you familiar with that transaction?

A. No, sir, Archie did that.

Q. Archie Koyl worked that out?

A. Yes, sir.

Q. Well, did you have any particular knowledge at the time that there was some sort of an arrangement for transactions in cash only between your company and the Keenan Pipe and Supply?

A. I didn't know it was cash only.

Q. There has been some testimony here by a plumbing contractor by the name of Lloyd—

The Court: Before you get into that, I would like to [243] understand his last answer. It was a little bit cryptic to me. He didn't know it was cash only. Well, what did you know about it?

The Witness: Well, I was of the opinion that there was trading with them. I remember one trade of some trucks for materials.

The Court: Well, didn't you know there were substantial transactions involving purchases from Keenan?

The Witness: No, sir.

(Testimony of Gene O. Clark.)

The Court: Do you know whether or not there was any question of getting a discount of one-third by paying cash to Keenan?

The Witness: Did you say whether there was a question?

The Court: I say do you know anything about it?

The Witness: No, sir.

The Court: You never heard of anything like that until you heard Mr. Koyl testify to it, is that your statement?

The Witness: No, I have heard it before.

The Court: Well, when did you first hear about it?

The Witness: Possibly two years ago on a trip out here.

The Court: And never until then?

The Witness: No, sir.

The Court: Well, where is Keenan located?

The Witness: They are off Santa Fe Avenue. It is in [244] Los Angeles City, about 30th Street or 34th.

The Court: All right, go ahead.

Q. (By Mr. A. Baird): Mr. Clark, there has been some testimony here by a plumbing contractor by the name of Lloyd Meissenburg. Mr. Meissenburg testified that he purchased or arranged to purchase or did purchase a quantity of material consisting of some 8, 9, or 10 truckloads, and that in making the payment for that material you came to his office and he paid you \$12,000 in cash in addition to

(Testimony of Gene O. Clark.)

some further payment by check which was made either then or later. You heard that testimony this morning?      A. Yes, sir.

Q. Is that testimony correct?

A. Yes, sir.

Q. Mr. Meissenburg gave you the \$12,000 at that time?      A. Yes, sir.

Q. And what did you do with it?

A. Took it back to the shop.

Q. What did you do with it then?

A. Paid Archie.

Q. You paid Archie?      A. Yes, sir.

Q. What do you mean when you say you paid Archie? Will you elaborate on that a little?

A. That was at that time when I was buying all of [245] Archie's stock.

Q. That was some time about February, 1948?

A. Yes, sir.

Q. And you say that was at the time you were buying all of Archie's stock?

A. Yes, sir.

Q. Where did you make this payment to Archie?

A. At the shop.

Q. And was that in part payment of his interest in Gene Clark Plumbing or in Gene Clark, Inc.?

A. In Gene Clark Plumbing.

Q. With reference to the balance of that transaction that was paid in by check as I remember it, do you know what was done with the check?

A. Yes, sir.

Q. What happened to that?



(Testimony of Gene O. Clark.)

A. I deposited it in Gene Clark Plumbing account in El Monte Bank of America.

Q. You did not deposit it in the Gene Clark, Inc. account?      A. No, sir.

Q. What did you do with the funds—well, I will withdraw that, Mr. Clark. I am not sure that is material. Until I know, I will withdraw the question.

The Court: You are not going to get away from that [246] \$10,000 without having him explain what, if anything, he did about it, are you? The \$10,000 cash.

Mr. A. Baird: You are referring to the \$12,000, your Honor.

The Court: \$12,000, I am sorry, yes.

Mr. A. Baird: He has stated.

The Court: Well, he stated he paid the money to Archie, yes, but he hasn't stated whether it went on the books of the corporation or didn't go on it or whether he included it in his income tax return or not or in the corporation income tax return or not. He stated everything that gets down to the point of where it makes a difference and I'd like to hear the rest of it.

Mr. A. Baird: Very well.

Q. (By Mr. A. Baird): Will you state whether or not this \$12,000 which you received from Mr. Meissenburg was reported in the bank account or on the books of Gene Clark, Inc.?

A. No, sir.

Q. Do you know whether or not it was reported

(Testimony of Gene O. Clark.)

as an income item for materials sold on your individual return?      A. It was not.

Q. Will you state to the Court whether or not these particular materials were materials which you in your own mind identified or considered to be materials of Gene Clark Plumbing [247] as distinguished from Gene Clark, Inc.?

A. That is the way we considered it.

The Court: Well, it is a pretty leading question, Mr. Baird, especially when this witness just got finished testifying that he paid the money over to Archie for Archie's interest in Gene Clark Plumbing.

Mr. A. Baird: Well, I think I can see how your Honor might draw an inference from that, but as I understand the situation he was in the process of liquidating whatever he could and making a settlement with Archie Koyl. Now, this was one, as I understand it, kind of transactions that were entered into in getting money into the hands of Archie Koyl.

The Court: Well, he took \$12,000 which he didn't report and which he didn't count—account for and turned it over to Archie Koyl, according to his statement, for something. Was it either Archie Koyl's interest in the Gene Clark Plumbing Company or an indebtedness or an obligation or a trade or something of that kind? I am not clear as to what it was yet.

Mr. A. Baird: I am not sure that the witness can make it any more clear because we have labored under difficulties of that kind for some time.

(Testimony of Gene O. Clark.)

The Court: Let him make one more try, Mr. Baird.

Mr. A. Baird: Very well.

The Court: What were you going to get for the \$12,000 which you turned over, you say, to Archie? What were you going [248] to get for it?

The Witness: Nothing.

The Court: You mean you were giving it to him?

The Witness: No, sir, it was a part of his payment for that part of the plumbing materials owned by Gene Clark Plumbing.

The Court: Well, then, you were paying something that was owed to him, is that correct?

The Witness: Yes, sir.

Mr. A. Baird: Is your Honor through?

The Court: I suppose so.

Q. (By Mr. A. Baird): Mr. Clark, as I understand it, this \$12,000 was a part of a rather substantial amount which was involved in this transaction. In other words, Mr. Meissenburg, in addition to the \$12,000 to which you have referred, also had given you a check for \$3,074.74, which has been introduced here as Respondent's Exhibit LL, and on February 9th, 1948, had given you a check for \$22,935, with a notation on it "Material in Full" and which has been introduced as Respondent's Exhibit MM.

Will you tell us what you did with those checks?

A. I deposited those in the Bank of America at El Monte.

(Testimony of Gene O. Clark.)

The Court: Well, let me try once more here. I still don't understand this \$12,000 item. You testified that when Archie came along with you, he had \$1,500. [249]

The Witness: Yes, sir.

The Court: So, unless it was added on later, he didn't have very much capital?

The Witness: Yes, sir.

The Court: You were the one that had the capital. Then you testified that while in the beginning you only took over part of the materials, inventory of Gene Clark Plumbing, that sooner or later they got mingled, but in the meantime Archie had an interest in Gene Clark, Inc., too?

The Witness: Yes, sir.

The Court: Now why did you have to pay Archie \$12,000?

The Witness: Well, in the starting of the Gene Clark Plumbing, he let all of his commissions stay in the company. He brought in additional materials that he was credited with, and this was a balance of all that he had put into the Gene Clark Plumbing.

The Court: So you were using this money to pay out his share, is that it?

The Witness: Yes, sir.

The Court: Well, who is this share going to belong to? Did it belong to the corporation or to you or what?

The Witness: No, sir, belong to Archie.

The Court: Well, yes, but you paid him \$12,000

(Testimony of Gene O. Clark.)

for that. Who got it? Who got the share? [250]

The Witness: That wasn't in the corporation, sir.

Mr. A. Baird: It was a liquidation of the material, your Honor.

The Court: Well, does he mean that he liquidated the material himself and was paying Archie's share to him or what?

Mr. A. Baird: Well, I would say that, drawing what seems to be a reasonable inference from the figures involved, the amount of the two checks, \$22,935 and the other check of \$3,074.74 which the witness says that he put in his own bank account, is that happens to be roughly, I am told by Mr. Claypoole, 70 per cent of the total, so that the \$12,000 would represent roughly, not to the precise penny, but roughly, 30 per cent.

The Court: In other words, they were splitting the Meissenburg money 70-30, and Archie got his in the \$12,000 cash and Mr. Clark got his through the checks?

Mr. A. Baird: I would say that is a reasonable inference from documentary facts that we have.

The Court: All right, I think we might well recess at this time. [251]

\* \* \* \* \*

[Endorsed]: Filed April 25, 1955.



[Title of Tax Court and Dockets Nos. 48542-3-4.]

Los Angeles, California, April 1, 1955

9:30 O'Clock A.M.

PROCEEDINGS

GENE O. CLARK

was recalled by and on behalf of the petitioners, and having been previously duly sworn, was examined and testified further as follows:

Direct Examination—(Continued)

Q. (By Mr. A. Baird): I want to direct your attention to certain purchases of certain farm property down in Kansas, and will you tell the Court briefly what, if any, plans the Gene Clark, Inc. had with reference to acquiring of farm property in Kansas?

A. Yes, sir, I made a trip to Kansas to look over property.

Q. Can you tell us approximately when that was?

A. In 1946.

Q. In 1946. Very well.

A. And I looked at property that I thought would be good, and I came back and we decided that it would be well if the corporation bought. So I went back to Kansas and started making arrangements to purchase. When I found that the corporation in Kansas could not own or operate a farm, I came back and notified the corporation; and since I felt it was quite a good buy, I made arrangement to go ahead and purchase this farm myself. [255]

(Testimony of Gene O. Clark.)

Q. And that is commonly referred to in our discussions as the north farm? A. Yes, sir.

Q. May we have that map here?

\* \* \* \* \*

Q. (By Mr. A. Baird): Now, what arrangements did you make with your corporation in regard to obtaining money for the purchase of this farm?

A. I believe I borrowed \$10,000 from the Valley City Supply for a part of the down payment, and I borrowed some from the corporation, of which I proposed to give the corporation [256] a note for. I think, at that time, we proposed that the corporation would operate this farm, though, not own it, but operate it.

Then, on another trip back to Kansas, I found that they couldn't own or operate, so then I took over the operation as an individual.

Q. And at or about that time, did you have some discussion or controversy with Archie Koyl relative to the manner in which the title to this farm had been taken? A. No, sir.

Q. Well, you heard Mr. Koyl's testimony, did you not? I believe he testified here to the effect that you had taken title to a piece of property in your name and he wasn't very happy about that.

Mr. Machtinger: Objection. Mr. Koyl has not testified in this proceeding and that is testimony in another procedure. I think counsel, for the record, should state the question specifically and not refer to outside testimony in another proceeding.

(Testimony of Gene O. Clark.)

Mr. A. Baird: It is a matter of no consequence. I will withdraw it.

Q. (By Mr. A. Baird): Mr. Clark, I will ask you to state whether or not it is true that pursuant to some discussion that you had had with Archie Koyl, that it was decided that another farm would be [257] acquired in Kansas in Archie Koyl's name? A. That is correct.

Q. And that was done, was it not?

A. That is correct.

Q. And that is referred to on the map, Petitioners' Exhibit 25, as the South Farm, is it?

A. That's correct.

Q. And I notice on this exhibit there is also a farm designated as the Gene Clark West Farm, the Buffalo Ranch. A. Yes, sir.

Q. That was something you acquired when?

A. I believe I bought that in 1948.

Q. That Buffalo Ranch has nothing to do with the transactions between you and Archie Koyl?

A. No, sir.

Mr. A. Baird: Now, at this time, Mr. Machtinger, we would like to offer in evidence, to make the record complete, a photostat of the minutes of the board of directors, dated September 16, 1946, and July 22, 1946, and March 10, 1948. We have given you copies of these.

Mr. Machtinger: Respondent has no objection to the admission of these documents subject to our right to examine the original and for the pur-

(Testimony of Gene O. Clark.)

pose of checking whether or not they conform to the original minutes. \* \* \* \* [258]

Q. (By Mr. A. Baird): Now, there has been introduced in evidence as Petitioners' Exhibit 19, a ledger sheet, and I desire to direct your attention, ask you to look at account No. 10 of the general ledger, the date of 1947, and particularly to the item of \$27,518.99, and ask you to state whether or not that represented a note receivable from you to the corporation? A. It did.

Q. And can you state whether or not that \$27,518.99 indebtedness there to the corporation arose by reason of your acquisition of the farm property in Kansas to which you have referred?

A. That's correct.

Q. Now, at the time, Mr. Clark, that you acquired the stock of Archie Koyl, did you enter into an agreement with him indicating and specifying what the consideration was that you were to pay him for the stock?

Perhaps my question isn't well put. I will withdraw it.

I show you this photostat of an agreement dated the [259] 28th day of January, 1949, and direct your attention to the signatures on the signature page, and ask you if those are the signatures of Archie Koyl, Fawn A. Koyl, and Gene O. Clark?

A. They are.

Q. My associate corrects me. This agreement is in 1949 and it relates to your sale of your stock to Mr. Koyl. A. That is correct.

(Testimony of Gene O. Clark.)

Q. Is that right? A. That's correct.

Mr. A. Baird: We would like to offer this in evidence, Mr. Machtinger.

Mr. Machtinger: If the Court please, I have seen this photostat during the course of this trial. I have not seen the original; there has been no explanation as to where the original is. I think that question is important since on page 3 of this photostat, paragraph 8, there is written through that paragraph the word "void" with certain other words that are not readily legible. It is that paragraph which goes to the \$27,000 item which counsel is now questioning the witness about. There has been no explanation as to whether this document is offered with this paragraph considered excluded; there is no explanation as to where the original is, whether original had any delineations through it, and because there has been no proper foundation laid for the introduction of this photostat, I must object on that basis. [260]

\* \* \* \* \*

Q. (By Mr. A. Baird): Mr. Clark, directing your attention to paragraph 8, which reads: "Koyls hereby agree that they will assume the payments to Gene Clark, Inc. of \$27,518.99, now owed by Clark to the corporation, and will supply a trust deed to secure the payments thereof," naming Gene Clark, Inc. beneficiary on property owned by Koyls at 6833 Eastern Avenue, Bell Gardens, [261] California. Koyls further agreed that they will cause the corporation to release the trust deed now on



(Testimony of Gene O. Clark.)

the books of the corporation, securing the payment of said amount by Clark to the corporation.

I will ask you now, you will notice that, written across that paragraph 8 are the words "void, see attached sale affirmation." Now, I will ask you to state to the Court whether or not these words written across that paragraph 8 were on there at the time that you signed this agreement?

A. They were not, because that was certainly my opinion at the time of this agreement.

Q. Do you know who wrote that writing, "void, see attached sale affirmation"? A. I do not.

\* \* \* \* \* [262]

Mr. Machtinger: I will withdraw my objection as to Petitioners' Exhibit 27 as long as it is stipulated by counsel that the original from which this copy was made is in all respects identical with this copy and includes thereon the word "void," through paragraph 8.

Mr. T. Baird: I will swear to that under oath. I will so stipulate.

Mr. Machtinger: Thank you.

The Court: All right. It will be received.

\* \* \* \* \*

Q. (By Mr. A. Baird): Mr. Clark, Exhibit 27 which is the agreement that you executed on the 28th of January, 1949, when you sold out to Archie Koyl, contains, among other things, the agreement on the part of Archie Koyl that he would assume your liability to the corporation for the amount of \$27,518.99? A. That's correct. [264]

(Testimony of Gene O. Clark.)

Q. Was there ever any change in that agreement?      A. No, sir.

Q. I notice by referring to Petitioners' Exhibit 19 that the general ledger account No. 110, has the title "Notes Receivable, Officers," which has been stricken out and above that is written "Trust Deeds." Do you know who altered the heading of that record?      A. No, sir.

Q. Was that alteration done pursuant to your direction?      A. I don't believe it was.

Q. Did the corporation ever own any trust deeds?      A. No, sir.

Q. Did either you or Archie Koyl ever give the corporation trust deeds as security for the obligations which you owed the corporation?

A. No, sir.

Q. I will ask you to state whether or not that was contemplated at one time?

A. Not at any time.

Q. Well, let me refresh your recollection. Referring now to the agreement, Petitioners' Exhibit 27, there is some reference here in the paragraph 8 about which you have been talking that the Koyls further agree that they will cause the corporation to release the trust deed now on the books of the corporation securing the payment of said amount by Clark to the corporation. Had you ever given the corporation a trust deed to secure that \$27,518.99?      A. No, sir.

Q. Had Archie ever given the corporation a trust deed to secure his obligation?

(Testimony of Gene O. Clark.)

A. He was supposed to on the Bell Gardens property.

Q. That is correct. He was supposed to, but did he?      A. I don't know, sir.

Q. You don't know.

The Court: Before you get from the farm subject, there are one or two facts that are no doubt clear to you, but not clear to me. You must remember, these details come to me out of the blue and if you were about to pass on it, I would either like to ask the witness a few questions or get some information. [266]

\* \* \* \* \*

The Court: You, in mentioning how you got the money to pay for the farm, you said you borrowed part of the money from the corporation, and you said you borrowed part of the money from some other organization, the first name of which was Valley; Valley what?

The Witness: Valley City Supply.

The Court: Valley City Supply. Now, what do you mean by borrowing the money from them? Was it a direct loan from them to you?

The Witness: Yes, sir.

The Court: This was not a question of taking some amount of cash or check from Valley and using it and obligating yourself to Gene Clark, Inc.?

The Witness: No, sir. I borrowed \$10,000 and I

(Testimony of Gene O. Clark.)

paid him back very promptly. It was just a matter of days.

The Court: Well, what was the amount of cash that you said you borrowed from Gene Clark, Inc.?

The Witness: The farm cost \$40,000 and I got a [267] mortgage from the bank for \$18,500, and the balance I put ten that I borrowed from Valley City, and whatever the balance would be I borrowed from the corporation.

The Court: You seem to be, in your testimony, that balance you did name an amount before, I thought of around \$10,000. I may be mistaken, but it differed very widely from the \$27,000 indebtedness shown on the books. Now, I would be glad to have that explained for completeness.

Mr. A. Baird: Well, if your Honor please, perhaps I can explain that in this way: By reference to Petitioners' Exhibit 19, and the ledger account, it will be observed that the indebtedness of Clark and Koysl at one time was Clark, \$25,000, Koysl, \$10,844.79, and that is as of the date of March 31, 1948, or rather, April 30, 1948. The indebtedness on the part of Mr. Clark of \$47,518.99 has been reduced by the application of \$20,000, which Mr. Clark has testified was the difference which he had received from the corporation.

Now, there is one further link in it which helps clarify the matter perhaps and that is at the time that Mr. Koysl sold out to Mr. Clark, there was an agreement and we have that, whereby Mr. Clark agreed to—— \* \* \* \* \* [268]

(Testimony of Gene O. Clark.)

(The document above referred to heretofore marked Petitioners' Exhibit No. 29 for identification was received in evidence.)

Mr. A. Baird: This is dated the 29th day of March, 1948, and it indicates that Mr. Clark had agreed to assume the liability for the \$10,844.79, which Mr. Koyl owed the corporation. He also agreed to assume on accounts receivable \$1,540.13, as indicated by the Exhibit 29.

The Court: All I want to get clear in my head, the witness has kept talking about the entire \$27,000 as being attributed to the farm arrangement. I gather now that it is the result of a number of things that happened, including what you have just described, and that the amount he borrowed from the corporation is what he originally testified he borrowed in relation to the farm? [269]

Mr. A. Baird: I think it is true, and I believe there is no dispute about it, that the \$27,000 item is the end result of a number of transactions, which in the main, center around these farm deals.

\* \* \* \* \*

Q. Mr. Clark, in 1948, or perhaps before, you can correct me on the date if I am wrong, I will ask you to state whether or not you employed a firm of accountants in Independence, Kansas, for the purpose of doing whatever auditing was necessary, keeping whatever records were necessary in connection with your farm operation? A. I did.

Q. And can you give us the name of that firm of accountants?



(Testimony of Gene O. Clark.)

A. That is Joseph Acre, A-c-r-e, certified public accountants.

Q. And do you know when they first began doing work for you?

A. Yes, sir. I saw Joseph Acre when I first bought the farm, because I wouldn't be there and I wanted him to keep, help Dad keep it straight.

Q. Well, can you tell us now, was that in 1947 or '48?      A. That was in '46.

Q. Oh, in '46?      A. Yes, sir.

Q. Now, did he make out your income tax returns for 1946 and 1947?      A. No, sir.

Q. Who made out your individual income tax return?

A. Either Mr. Files or whomever he might have had do it.

\* \* \* \* \*

Q. (By Mr. A. Baird): Now, Mr. Clark, the returns for the year 1947 — and I show you Joint Exhibit 6-F, have no indication on the return [271] as to whom it was prepared by. Do you know who prepared that return?

A. I believe Freddy Files.

Q. Was that prepared on or about the last day of the filing period?

A. It was the last day. [272]

\* \* \* \* \*

#### Cross Examination

Q. (By Mr. Machtinger): Mr. Clark, you testified with respect to the inventory of the Gene Clark Plumbing organization on or about May 1,

(Testimony of Gene O. Clark.)

'46, when the corporation was formed, that there were actually two separate inventories; is that correct?      A. That is correct.

Q. Where were those inventories physically located?

A. In both El Monte and Bell Gardens shops.

Q. There were not, then, ever inventories located in any other place than those two shops?

A. No, sir.

Q. With respect to the inventory that was allegedly not belonging to the corporation, was that held for the purpose of sale?      A. No, sir.

Q. What did you hold it for?

A. For the purpose of—for the plumbers to use.

Q. Which plumbers? Those belonging to the corporation?

A. That is all there were; yes, sir.

Q. Although it was held for the purpose of use by the [277] corporation, are you testifying that it was not corporation property?

A. That is correct.

Q. What procedure did you use for accounting between the corporation and anyone who might have loaned this other inventory?

A. I'm not quite sure I know what you mean by "accounting".

Q. Did the corporation ever account to you, did it ever pay you for this inventory which it was using that supposedly did not belong to the corporation?      A. No, sir.

(Testimony of Gene O. Clark.)

Q. Were you giving it as a gift to the corporation?  
A. No, sir.

Q. I don't understand with respect to this point: You say the corporation did not pay you for the inventory which it took from this separate pile or this segregated inventory which did not belong to the corporation, is that correct?

A. That is correct.

Q. And the corporation never placed on its books as purchases this property from any other source, referring to this specific inventory? Did it record it as a gift to the corporation?

A. No, sir.

Q. It recorded it as a purchase from you? [278]

A. No, sir.

Q. In other words, the corporation used it, and never picked it up in its own inventory, is that right?  
A. That is correct.

Q. Now, with respect to the record-keeping of this separate inventory, how did you view the corporation's acquisition of such inventory? Did you make any accounting for your own purposes?

A. Only in dollars and cents.

Q. For what purpose did you make that accounting?

A. So when or if we could dispose of it, or if the corporation, when or if they didn't need it any more, we could get an equal amount back.

Q. Who is the "we" to which you are referring?

A. Archie Koyl and myself.

(Testimony of Gene O. Clark.)

Q. Did both of you own this separate inventory?

A. Yes, sir.

Q. And what percentage of ownership did you have in that inventory? Did you each own 50 percent of it?

A. No, sir.

Q. What percentage did you have?

A. I don't know. That is a definite percentage, or that it wasn't a definite percentage; it was a matter of how much he had contributed and how much I did.

Q. Well, how much did you consider that you had [279] contributed to it and how much did you consider Mr. Koyl had contributed to it?

A. I think—Of course, I had more than Koyl, but I believe Koyl had somewhere around 30 percent in it.

Q. At what time did his inventory accumulate?

A. This inventory accumulated back before Koyl came there, partially.

Q. This inventory accumulated during the time when you were operating the Gene Clark Plumbing Company?

A. That is correct.

Q. Did the inventory belong to the Gene Clark Plumbing Company?

A. Yes, it did.

Q. It belonged to you and Mr. Koyl as owners of the Gene Clark Plumbing Company, is that correct?

A. That's correct.

Q. Did you take an inventory on or about May 1, 1946, when the Gene Clark organization incorporated?

A. Yes, sir.

Q. Was that taken by the old organization?

(Testimony of Gene O. Clark.)

A. Gene Clark Plumbing, you mean?

Q. Well, strike that question.

Who took the inventory?

A. Archie and myself.

Q. Was anyone else present when you took the inventory? [280]

A. They were probably present.

Q. Did you take an inventory of all the stock and assets of the organization? A. Yes, sir.

Q. Did the Gene Clark Plumbing Company, prior to incorporation, maintain books and records?

A. Yes, sir.

Q. To the best of your knowledge, were those books and records accurate? A. No, sir.

Q. To what extent were they not accurate?

A. We never did keep an accurate record; that is to say, on the books of the entire inventory.

Q. You say the entire inventory did belong to the Gene Clark Plumbing Company prior to incorporation? A. That is correct.

Q. Why didn't you keep an accurate record of inventory?

A. Because we used so much of it for the purposes of selling to obtain cash to buy above ceiling prices and on priorities that if we had it in our inventory, we would have automatically been halted from buying these additional materials.

Q. When you took your inventory on or about May 1, 1946, you say you took an inventory of the entire stock of the corporation, or that organization; is that correct?



(Testimony of Gene O. Clark.)

A. Of the Gene Clark Plumbing. [281]

Q. Did the Gene Clark Plumbing Company's books reflect the true inventory as of May 1, 1946?

A. No, sir.

Q. Was anyone other than you acquainted with what that true inventory was? A. Yes, sir.

Q. Who else would have known that?

A. Mr. Koyl.

Q. When you took the inventory on May 1, 1946, did you physically segregate the inventory which allegedly did not belong to the corporation?

A. We did.

Q. Why did you make that segregation?

A. Actually, we were going to try to separate it and keep it straight that way, but there wasn't enough inventory that we could put into the corporation to let them operate, hence, it was impossible.

Q. How soon after May 1, 1946, were the two inventories mingled, commingled?

A. Very promptly.

Q. Let's say three months after May 1, 1946; would it have been possible for anyone to go into your yards and both shops and determine whether there was any inventory there that did not belong to the corporation?

A. It would have been impossible. [282]

Q. How could you tell at that time what belonged to the corporation and what belonged to any other party?

A. Actually, an inventory you couldn't, only in dollars and cents.

(Testimony of Gene O. Clark.)

Q. What do you mean you could tell in "dollars and cents"?

A. If you took an inventory, deducted that which we had in it, the balance is the corporation's.

Q. Did the corporation purchase any stock after May 1, 1946? Did the corporation make any purchases after May 1, 1946? I assume it did.

A. Material?

Q. Material. A. Yes, sir.

Q. And those materials were placed together with the other inventory that you then had?

A. That is correct.

Q. There was no way you could tell what belonged to the corporation and what may have belonged to someone else, is that correct?

A. Not as materials, you couldn't tell.

Q. Did you ever buy materials—strike that question.

Did the Gene Clark Plumbing Company, other than the organization, exist after the date at which the corporation was formed? [283]

A. Yes, sir.

Q. What was the function of the Gene Clark Plumbing Company after the corporation was formed?

A. Only in the purchasing of materials and sales of materials.

Q. Then, you say that you purchased materials for Gene Clark Plumbing Company as distinguished from Gene Clark, Inc. after May 1, 1946, is that correct?

(Testimony of Gene O. Clark.)

A. Would you state that question again, please?  
(The question was read by the Reporter.)

The Witness: No, sir.

Q. (By Mr. Machtinger): Now, you stated the question before this, or perhaps two questions before, that Gene Clark Plumbing was in existence after May 1, 1946. A. That is correct.

Q. And you stated its function was for the purpose of purchasing materials and selling materials?

A. Correct.

Q. So that you did buy materials for Gene Clark Plumbing Company after May 1, 1946, is that correct, Mr. Clark? A. We bought materials.

Q. Who was "we"? A. Archie and I.

Q. Did you buy them for the corporation? [284]

A. We bought them for the inventory, whether it was the corporation or Gene Clark Plumbing.

Q. Did you consider that at any time when anyone purchased materials after May 1, 1946, that those materials did not belong to the corporation?

A. If they purchased materials, they would purchase them from Gene Clark Plumbing.

The Court: I don't get this at all. If who purchased materials it would be from Gene Clark Plumbing?

The Witness: Well, a customer.

The Court: Well, why would he purchase from Gene Clark Plumbing rather than Gene Clark, Inc.?

The Witness: Well, your Honor, at that time the reason why we did that was that the licenses had

(Testimony of Gene O. Clark.)

now been turned from Gene Clark Plumbing to Gene Clark, Inc. Now, the selling of materials, if you sold them for more than the ceiling, you were subject at all times to having your license taken away from you. Now, Gene Clark Plumbing was not the carrier of a license at this time, and should these sales be discovered, they couldn't take our license away from us.

The Court: So you did make over-ceiling sales for Gene Clark Plumbing, is that correct?

The Witness: Yes, sir.

The Court: Did you ever include them in your income tax return? [285]

The Witness: No.

The Court: Now, that was in 1946. What about 1947?

The Witness: We continued.

The Court: And didn't include them in your income tax return?

The Witness: No, sir.

The Court: As a matter of fact, you don't show any income in your income tax return from any plumbing business other than salary or what-not from Gene Clark Plumbing after 1946, do you?

The Witness: That is correct.

The Court: What about 1948? Did the same happen?

The Witness: Yes, sir.

The Court: What about 1949?

The Witness: Gene Clark Plumbing was no longer in existence.

(Testimony of Gene O. Clark.)

The Court: Well, isn't it a matter of fact that you dealt with Gene Clark Plumbing and Gene Clark, Inc. just about as you pleased without having any particular regard for the corporate entity at all?

The Witness: No, your Honor. The object of it all was to protect the corporation.

The Court: What do you mean by the protection of the corporation?

The Witness: Well, by Gene Clark Plumbing accepting [286] the responsibility of being caught in an over-ceiling sale, we protected the corporation, and also there was never a time that I believe either Archie Koyl or myself ever kept any of the monies between '46, '47 and '48, up until we sold.

The Court: You say you didn't keep the monies. You used them for materials, which again you resold at a profit, didn't you?

The Witness: Yes, sir.

The Court: Whether you kept the money or not, you did realize a profit from these over-ceiling transactions in '46, '47 and '48, didn't you?

The Witness: Your Honor, I believe the corporation received it.

The Court: You just got through saying ten minutes ago or less that Gene Clark Plumbing was the one that made the over-ceiling sales, so that if you got caught at it, you wouldn't lose your license?

The Witness: That's right, your Honor.

The Court: Well, Gene Clark Plumbing was not the corporation?



(Testimony of Gene O. Clark.)

The Witness: But, your Honor, if we put in, say, \$40,000 worth of materials in 1946, and we took out only \$40,000 worth in 1948, at the end of the time when it was needed, then, the sales or the profits, if any, would have reflected back to the corporation. [287]

The Court: Suppose it did reflect back to the corporation in the first instance. They were profit of Gene Clark Plumbing, weren't they?

The Witness: Yes, sir.

The Court: The inventory that was sold belonged to Gene Clark Plumbing. Gene Clark Plumbing sold it at a profit, sold it over-ceiling, isn't that correct?

The Witness: That is correct.

The Court: And never reported it?

The Witness: That is correct.

The Court: And ultimately, for better or for worse, the funds may have gotten into the corporation, but the corporation didn't report it either, did it?

The Witness: Yes, sir.

The Court: Well, when did the corporation report these over-ceiling profits that you are talking about for income tax purposes?

The Witness: I am not familiar with bookkeeping, but wouldn't it be when you get at the end of the year and you take the business and the inventory, wouldn't the balance be the profit?

The Court: Well, a great deal may be said about that, but there are no facts in this case to establish

(Testimony of Gene O. Clark.)

that you did anything of that sort and, if so, it would be a great deal of explanation required of it. The only thing we have gotten clear [288] so far is that you did make a profit as individuals, or joint adventurers, or whatever you may want to call it, separate and distinct from the corporation, which you didn't report in your income tax returns, isn't that correct?

The Witness: That's right.

The Court: And you didn't even have any normal books for Gene Clark Plumbing while you were doing this, did you?

The Witness: No, sir.

The Court: Well, what split-up was there, if any, between you and Archie Koyl as to these profits, or did you just get the benefit of it through your interest in the corporation?

The Witness: Your Honor, we didn't believe—I understand and I think you are correct—but we didn't believe there was a profit. We only got it in our corporation.

The Court: Mr. Clark, you didn't believe that there was a profit when you bought something at one price and sold it at a higher price? You didn't think that was a profit?

The Witness: Your Honor, I knew it was, yes, sir.

The Court: And you didn't report it. Now, incidentally, while I am asking you a few questions, I might well ask you a few more; aside from all of the preliminary statements and arguments that

(Testimony of Gene O. Clark.)

have been made, you understood what these transactions were for, that the agent described as substituted items, didn't you?

The Witness: Yes, sir, your Honor. [289]

The Court: And that was an intentional method of getting cash out of the corporation. You have testified it was for the purchase of materials, but in all events, it was an intentional method of getting money out of the corporation without actually recording it on the corporation's books, wasn't it?

The Witness: I am not awful sure I understand you.

The Court: Well, weren't you perfectly sure in your own mind that there were two items, and that one was substituted for the other, and that only one of the two was on your books?

The Witness: Your Honor, in all of this business, in the contracting business, when we took a contract to do a job for a given price, it was always my hopes and I always attempted to always have receipted and turned in for files all of the income from those jobs.

The Court: Well, Mr. Clark, you yourself testified that you used these methods to get available cash out of the corporation in order to buy materials. You testified to that, didn't you?

The Witness: Yes, your Honor.

The Court: Now, if you want to get cash out of the corporation, there has been other testimony—I don't know whether you have admitted it or not—But there has been other testimony that this method

(Testimony of Gene O. Clark.)

of not reporting certain sales on the books was your idea; is that correct or not? [290]

The Witness: That is correct.

The Court: It was your idea?

The Witness: Yes, sir.

The Court: You knew they weren't being reported, didn't you?

The Witness: The sales?

The Court: That's right.

The Witness: Yes, sir, your Honor.

The Court: You also assert that certain purchases weren't reported or additional amounts of cash paid out for purchases, but you do agree that sales were not reported on the books?

The Witness: Yes, sir.

The Court: Or any income tax returns?

The Witness: That's correct.

The Court: Where did you get that idea?

The Witness: Well, if somebody needed \$4,000 for merchandise, let's say, let's say it would be bathtubs, and we didn't have any bathtubs but we did have a lot of soil pipe, I would sell soil pipe to get the bathtubs.

The Court: That is a perfectly simple transaction. Why didn't you record these items on your books, the items that you admit were not recorded on your books or included in your gross income and your tax return? Why didn't you put them on your books? [291]

The Witness: Well, your Honor, I couldn't buy without cash.

(Testimony of Gene O. Clark.)

The Court: Well, you might not be able to buy without cash, but you could use cash and still put the record of it on your books, couldn't you?

The Witness: I am sure I could.

The Court: Well, why didn't you?

The Witness: I don't know.

The Court: Can't you do a little better than that, Mr. Clark?

The Witness: Well, as I said, I think that the hardest part was worrying about buying or selling over ceiling, and the priorities that we were using.

The Court: Well, you knew this affected your taxable income, didn't you?

The Witness: No, sir.

The Court: You didn't know that the omission of sales from your books and the omission of sales from your income tax returns, or the income tax returns of the corporation affected your income tax?

The Witness: Well, your Honor, I gave back the same amount of materials.

The Court: You gave back the same amount of materials, but you didn't account for the profits. You have already said that, haven't you? [292]

The Witness: Yes, sir.

The Court: Are you trying to tell me that if you bought a piece of property for \$50,000 and sold it for \$100,000 and then some time later took that \$100,000 and put it in another piece of property that you hadn't gained \$50,000?

The Witness: That is correct, your Honor, but that is what I felt the corporation would feel the



(Testimony of Gene O. Clark.)

profits of the retail sales. Of course, oftentimes, your Honor, there would be a profit, true, in the retail sale, but we also were paying terribly high prices, double to sell and double to buy back again.

The Court: All right. If you recorded all that on the books of your organization, then somebody might have been able to understand the net result. This way nobody can understand it, is that correct?

The Witness: That is correct.

The Court: Well, one other question and then I will permit Mr. Machtinger to proceed. Why was it that you reported on your income tax returns as you so testified at any rate, a 50-50 distribution between you and Archie Koyle in 1945, and I think in 1946, when you claim that was not the actual distribution?

The Witness: I signed them. I did not know.

The Court: You did not know it at the time?

The Witness: No, your Honor.

The Court: You know it now, don't you? [293]

The Witness: Yes, sir, your Honor.

The Court: Well, have you attempted to make any adjustment in that respect?

The Witness: I only knew it less than a month ago.

The Court: All right. Go ahead, Mr. Machtinger.

Q. (By Mr. Machtinger): Mr. Clark, did you and Mr. Koyle ever have an accounting at the end of either the calendar year on which you and Mr. Koyle figured your tax returns or at the end of the corpo-

(Testimony of Gene O. Clark.)

rate fiscal year as to what property belonged to the corporation and what property belonged to Gene Clark Plumbing?

A. Only when we took an inventory.

Q. You did take an inventory at the end of the calendar—at the end of the corporation fiscal year?

A. I am not sure we took it when Freddy told us to.

Q. And when Freddy Files told you to take an inventory, you took just one inventory, did you not?

A. That is correct.

Q. And that was the corporate inventory, was it not?

A. That was the combination of both.

Q. Did you and Mr. Koyl then get together and determine between yourselves what portions still belonged to you and what portions belonged to Mr. Koyl separately and apart from the corporation?

A. Didn't need to get together for that. [294]

Q. Did you ever tell him, or did he ever tell you, what each of you believed belonged to each other?

A. Yes, sir.

Q. What times did you confer to that extent?

A. That is available any time.

Q. Where was it available?

A. In my desk.

Q. What did you have in your desk that made it available?

A. I had two books that I kept that amount which we had spent and that amount which we had received.

(Testimony of Gene O. Clark.)

Q. What kind of books, were they, Mr. Clark?

A. I had two; I don't know. They are just notebooks that you would buy at the regular store, and then I also had one that I carried in my pocket.

Q. What did you record in these books?

A. In the office, I kept track of that which we had spent; that is, for example, Archie spent for materials or I did, and for the sales.

Q. When you refer to "we," you are referring there to you and Archie?

A. Yes, both of us did.

Q. As separate from the corporation?

A. That is correct.

Q. You allegedly recorded, then, what you and Mr. Koyl purchased outside of the corporation?

A. That is correct.

Q. For example, whom were you making these purchases for, Gene Clark Plumbing?

A. I don't know that I ever thought about it.

Q. You were just making purchases, is that it?

A. For the use of the corporation.

Q. And you would record the amounts of these purchases in this little black book, or whatever it was?

A. No, the one I had in my pocket was not necessarily the record. I only carried it because, oftentimes, if I were out on a job and sold materials or purchased some, in order not to forget, I simply made a note.

Q. And that little book you kept in your pocket contained records of purchases and sales by you?

(Testimony of Gene O. Clark.)

A. Yes, sir.

Q. What did the other books that you had in your desk contain?

A. The purchases and sales by myself and Koyl.

Q. What did you do with these records at any time?

A. I didn't do anything with them. I had them and Mr. Stutzman went over this.

Q. What was the purpose — aside from Mr. Stutzman—what was the purpose of keeping these records, Mr. Clark?

A. So that when, if there ever came a time when we could dispose of this inventory, he could have his share and I could [296] have mine.

Q. Did you ever use them for the purpose of computing profits or loss from your transactions?

A. No, sir.

Q. Did you ever show these books to anyone?

A. Yes, sir.

Q. Who saw these books?

A. Archie Koyl.

Q. Did you ever show them to your comptroller, Mr. Files?      A. I don't think so.

Q. Did you ever ask anyone to make any computations for you from these records?

A. No, sir.

Q. And these are the records which you state Mr. Stutzman took?      A. That is correct.

Q. When was Mr. Stutzman in to see you?

A. Mr. Stutzman was in about January of '49.

(Testimony of Gene O. Clark.)

Q. And for what purpose did he say he came to see you?

A. To check my personal records for the years of 1946, '47 and '48.

Q. And what record did Mr. Stutzman ask to examine?      A. All of my records.

Q. Who was there when Mr. Stutzman came?

A. Archie Koyl, Chick Ring, Freddy Files, myself, or any [297] of the employees.

Q. And of whom did he ask for these records?

A. He asked Archie Koyl—no, he didn't ask him. He asked Archie to see me.

Q. And did you give him the records?

A. Not at that time.

Q. What records did you give him?

A. I just simply opened the file and let him look at any that he wanted to.

Q. What file did you open?

A. My personal file.

Q. Did he ask to see the Gene Clark Plumbing Company records?

A. That is what he was checking.

Q. And if this was for the year 1947 and 1948, I understand?      A. '46, '47, '48.

Q. Well, did he examine the corporate records?

A. Not at all.

Q. Not at all. Did he check the corporate records at all for the purpose of determining whether you were properly reporting salaries from the corporation?

A. It is my opinion that Freddy Files asked



(Testimony of Gene O. Clark.)

him—it isn't an opinion—it is a fact; that Freddy Files asked him if he wanted to look at any of the books of the corporation and he [298] said, "I am not here to check the corporation." [299]

\* \* \* \* \*

The Court: It seems to me this testimony was clear enough that he was in and out a few times and it extended over a period, but I don't see it makes any difference here. I don't understand that there is any contention on the part of the Petitioner that any of the formal books of the corporation or Gene Clark Plumbing are missing. The only thing that is claimed to be missing is this: What has been referred to as a private memorandum of Mr. Gene Clark.

Q. (By Mr. Machtinger): Just one further question in that connection. Did anyone see you give Mr. Stutzman these personal records, see you give Mr. Stutzman these personal records?

A. I don't know that I gave them to him in the shop. He worked with them in the shop.

Q. Are you now stating that you did not—whether anyone gave him the records including yourself?

A. I gave him the records.

Q. Did anyone see you give him the records?

A. I took them to his home.

Q. When you took them to his home, was that on your own volition?

A. He asked me.

Q. He asked you to come to his home with your records?

A. That is correct.

(Testimony of Gene O. Clark.)

Q. Can you give us the approximate date when he asked you to come to his home? [300]

A. It was shortly after he was at the shop.

Q. Did you come to his home in the daytime or the evening? A. In the daytime.

Q. And this was during a week day?

A. That is correct.

Q. And when you came to his home, you gave him the records and left, is that correct?

A. No, I stayed quite a little bit.

Q. And did you leave the records with Mr. Stutzman? A. That is correct.

Q. At whose request? A. At his request.

Q. Is it—Mr. Clark, is it not true that you were aware that the corporation's tax returns were not being properly filed, inasmuch as they did not report the true income of the corporation?

A. I believe they reported the true income.

Q. Is it true, Mr. Clark, that you instructed your comptroller, Mr. Files, to set aside all cash that was received from cash sales and turn that cash over to you? A. At different times.

Q. Isn't it a fact, Mr. Clark, that you pleaded nolo contendere to a charge of evading the payment of income taxes due by Gene Clark, Inc. for the years 1948 and 1949, by filing false income tax returns, knowing the same to be false and in [301] violation of Section 145b of Title 26 of the United States Code?

Mr. A. Baird: Just a moment. Were you through with your question?

(Testimony of Gene O. Clark.)

I would like to be heard on that, your Honor.

The Court: All right.

Mr. A. Baird: Now, if your Honor please, it is my understanding, and certainly it is the understanding of some of our United States District Court judges in this district that a plea of *nolo contendere* is a plea that is to be confined solely to the particular case, and that the reason that the plea has been preserved under the current criminal rulings of procedure, and the reason that it was preserved in the existing rule of criminal procedure were enacted, was to protect an individual from being embarrassed in some other proceeding, civil or otherwise, which had nothing to do with the particular offense which he was charged in the criminal court, and we think there is authority for that position, and I would like to direct your Honor's attention to a few notations that I have made.

I may say that this plea is discussed in the *Cyclopedia of Federal Procedure*, 3d Edition, Volume II, Section 43.41 and continuing in the section following, Section 43.42, we find this statement:

"The plea has been left in the rules of criminal procedure to preserve a sometimes useful device by which a defendant may admit his liability to punishment without being [302] embarrassed in other proceedings."

Now, the footnote to that is *United States versus Pannell*, a Third Circuit case in 1949.

The Court: Is that an anti-trust case?

(Testimony of Gene O. Clark.)

Mr. A. Baird: I cannot answer that from my note. I do not know.

The citation is 178 Federal 2d 98. An excerpt from that opinion states:

“It appears that the plea was left in the present Rule 11 of the Federal Rules of Criminal Procedure to preserve a sometimes useful device by which a defendant may admit his liability to punishment without being embarrassed in other proceedings.”

That is found on page 100 of the volume to which I referred, 178 Fed. 2d.

The Court: Mr. Casey, will you make a note of that case so we can get the case for the Court, if necessary?

Mr. A. Baird: I will leave with you, Mr. Casey, this memorandum.

The Court: Go ahead.

Mr. A. Baird: In the well-known text, “Defending and Prosecuting Federal Criminal Cases,” second edition, by Housel and Walser, the following observation is made:

“The admission of guilt by a plea of *nolo contendere* is confined to the case at bar; it is not competent evidence [303] against the defendant in other cause, civil or criminal.”

And for reference to that, or footnotes to that editorial comment, is the *United States versus Lair*, 159 Fed. 47, and, in that case, *certiorari* was denied.

Now, I want to say to the Court that if we are going to get into this matter of a plea of *nolo con-*

(Testimony of Gene O. Clark.)

tendere, then, we would certainly want the right to bring in the circumstances under which it was entered; we would certainly want the Court to take cognizance of the fact that in this very case, this defendant was done a very grave injustice because this record shows beyond any question of a doubt that he was indicted for the filing of a false return of the corporation for a year in which he did not sign the return and at a time when he was not present and at a time when he had no interest in the corporation.

The Court: That is for one year?

Mr. A. Baird: As to one year, that's right, 1949.

The Court: That is not correct for 1948?

Mr. A. Baird: No, that was not correct as to 1948. But I do call that to the Court's attention, that those are the facts with reference to it.

Now, I do want to say further, that from my experience and the actual practice before our United States District Judges here, two other judges, in cases which I have personally appeared, in answer to objection which the United States District [304] Attorney as required by the Department of Justice to make to the receiving of a plea of nolo contendere, have taken the view that if there is some subsequent civil proceeding growing out of the same or similar transactions that it is proper basis for a plea of nolo contendere, and for that reason, two different cases in which I have appeared before two different judges, in this district, that plea has been accepted.



(Testimony of Gene O. Clark.)

And I think that for the reasons that I have stated, that it is wholly irrelevant and incompetent for this matter of what was done in criminal proceeding in the way of a plea of nolo contendere to be received.

Mr. Machtinger: If the Court please, the question of whether a plea of nolo contendere can be admitted in the record in a cause similar to this one as expressed before the Tax Court in the recent case of Lillian Kilpatrick versus Commissioner, cited by the Tax Court on May 28, 1945, and which is reported 22 Tax Court No. 59. In that case, the Tax Court stated that petitioners had made motions at the hearing to strike an exhibit, which exhibit was a certified copy of the judgment of the Court pursuant to the petitioner's plea of nolo contendere, and all references in the transcript relating to the nolo contendere pleas of petitioner, and one of her witnesses and their subsequent convictions thereon for income tax evasion for the years 1943, '44, and '45.

The Court stated that there were two questions raised. [305] First, whether the evidence as to their conviction is admissible in respondent's cross examination proper for purposes of impeaching the testimony of the petitioner, and whether the record of petitioner's conviction is admissible to prove her alleged fraudulent intent for the years 1943, '44, and '45.

In holding that the evidence was admissible, the Court stated that the Tax Court is bound by the

(Testimony of Gene O. Clark.)

rules of evidence applicable in the Court of the District of Columbia and the type of proceedings, which prior to September 16, 1938, were within the jurisdiction of the courts of equity of that District.

The Court stated that the term "conviction" used in the District of Columbia includes convictions based on *nolo contendere* pleas as well as based on jury verdicts. The Court denied petitioner's motion, that is, admitted the court record of conviction. In that connection they stated, we think they are admissible for impeachment purposes, as would be any conviction of crime committed by any witness and that they may be noted as part of the background of the present case.

The Court held, however, that it would refrain from deciding whether it was permissible to consider petitioner's plea as fraud issue.

Now, in this particular case, if your Honor please, the witness has denied that he had any knowledge that the corporation was filing false income tax returns. It would appear [306] to be relevant to the issue that the witness did plead *nolo contendere* to a charge which involved the corporation for years before this Court in view of the Tax Court's holding on this point, it is my contention that the question is proper and that there should be admitted a certified copy of the judgment of the District Court in the criminal proceeding.

The Court: Is that an opinion by Judge Oppen?

Mr. Alva C. Baird: Yes, it is, your Honor.

The Court: May I see it?

(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: May I call your Honor's attention to the fact that he specifically does not make any ruling to the effect of this competence to evidence to show fraud in this case?

The Court: Mr. Reporter, will you read the question which Mr. Machtinger asked the witness, to which petitioners' counsel objected.

(The question was read by the reporter.)

The Court: All you asked is if he had filed a plea of nolo contendere. As to that particular question, I will sustain the objection. Whether you want to rephrase it or not, it is up to you.

Mr. Machtinger: I do.

Q. (By Mr. Machtinger): Mr. Clark, you stated that you were not aware that the corporation was filing false and fraudulent income tax [307] returns, or the corporation was not reporting its true income on its returns, let's say, for the years 1948 and 1949, is that correct?

A. I was not aware.

Q. Why did you file——

Mr. Alva C. Baird: Would you pardon my interruption for just one question. May it be stipulated that he had nothing to do with the 1949 return?

Mr. Machtinger: No, I won't enter such a stipulation.

Mr. Alva C. Baird: Very well, go ahead.

Q. (By Mr. Machtinger): Why did you file a plea of nolo contendere to an indictment charging you for the offense of evading the payment of in-

(Testimony of Gene O. Clark.)

come tax due by Gene Clark, Inc. for the years 1948 and 1949, by filing false income tax returns?

Mr. Alva C. Baird: Just a moment, if your Honor please, I will want to ask that precise question, and will do so if permitted by the Court, if the Court rules against my position and holds that it is proper and admissible for Mr. Machtinger to establish that.

The Court: The question assumes that a plea of nolo contendere was filed, which is precisely the issue here. So far this question, just as the other one, has been limited to a plea of nolo contendere. If there is an objection—— [308]

Mr. Alva C. Baird: There is an objection.

The Court: Then, again as to the particular question, the objection is sustained.

Q. (By Mr. Machtinger): Mr. Clark, is it true you were convicted upon a plea of nolo contendere of an offense of evading payment of income tax by Gene Clark, Inc. for the years 1948 and 1949, by filing false income tax returns?

Mr. Alva C. Baird: Now, we renew our objection to that, and to the introduction of any records pertaining to any plea that he made of that kind.

The Court: Objection overruled. Answer the question.

The Witness: I was.

Q. (By Mr. Machtinger): Mr. Clark, would you look at this——

Mr. Machtinger: Would you please mark this Respondent's exhibit next in order?



(Testimony of Gene O. Clark.)

The Clerk: Respondent's Exhibit CCC marked for identification.

(Respondent's Exhibit CCC was marked for identification.)

Mr. Machtinger: If the Court please, I offer as Respondent's Exhibit CCC, a certified copy of the judgment of the District Court convicting Mr. Clark on his plea of nolo contendere of the offense of evading the payment of income tax by [309] Gene Clark, Inc. for the years 1948 and 1949 by filing false income tax returns.

Mr. Alva C. Baird: For the record, we renew our objection.

The Court: You are not objecting on the ground of lack of certification, as I understand it, but on the same grounds as previously?

Mr. Alva C. Baird: That's right.

The Court: It purports to be certified and I assume that it is. I will overrule the objection.

The Clerk: Respondent's Exhibit CCC will be admitted in evidence.

(Respondent's Exhibit CCC was received in evidence.)

Q. (By Mr. Machtinger): Mr. Clark, did you keep any of the cash that you received from the corporation for your own use other than sale—

The Court: I may say before you go into it further that—well, as I understand it, your objection was general as to the admissibility of the fact of conviction, is that correct?

Mr. Alva C. Baird: That is correct. And spe-



(Testimony of Gene O. Clark.)

cifically, I am objecting to it as any evidence of fraud in this case.

The Court: Well, I will admit for the purpose of impeaching the witness, and I will reserve consideration for argument on the briefs as to whether it may or may not be deemed [310] evidence of intent or any of the other elements of fraud for the purpose of this particular case.

Mr. Machtinger: Will you strike the last question, I will rephrase that question.

Q. (By Mr. Machtinger): There has been testimony, Mr. Clark, to the effect that Mr. Files, the comptroller, turned over cash received from sale of corporate stock to you, and that the sales were not recorded in the corporate records. Did you keep the proceeds of such cash for your own use?

A. No, sir.

Q. Now, Mr. Clark, in your 1948 and 1949 income tax returns, joint returns of you and your wife, you claimed approximately \$17,000 in farming expense for each of those years, which was conceded by the Government. Where did you get the \$34,000 that you used for the farm expenses?

A. That was my personal bank account.

Q. Where did you get the money that was in your personal bank account that you used for those expenditures?

A. By the sale of my materials.

Q. Didn't you testify shortly before that you used all the proceeds from the sale of your materials for the purpose of other materials?

(Testimony of Gene O. Clark.)

A. No, sir.

The Court: You mean you didn't say that or didn't do [311] it?

The Witness: I didn't do it.

The Court: Well, you did testify, didn't you, that you used all the money for the purchase of other materials?

The Witness: Not when I sold my inventory.

The Court: All right, go ahead.

Q. (By Mr. Machtinger): Do you recall how much in addition to the \$34,000 you had that you realized from the sale of the materials?

A. No, I don't.

Q. During what periods of time did you accumulate this money; during 1946?

A. No, sir.

Q. What period of time did you get the money?

A. That was accumulated over many years.

Q. Specifically when, Mr. Clark?

A. I accumulated that back as far as, oh, my goodness, back as far as '34.

Q. Mr. Clark, when you borrowed the \$10,000 from the Valley City Supply Company, which you used as part payment for the purchase of the North Farm, did you give a note to the Valley City Supply Company?      A. Not to my knowledge.

Q. Did you give a note to the corporation when you borrowed the balance of the moneys necessary for the purchase of [312] the farm?

A. Not to my knowledge.

Q. Do you have a copy of the agreement which

(Testimony of Gene O. Clark.)

was admitted as Petitioners' Exhibit 27, and which contains this Paragraph 8, which in Petitioners' Exhibit 27 has the word "void" struck through it; do you have in your own personal records a copy of this agreement?      A. I do not.

Q. Why, Mr. Clark, was it decided to buy a farm in Archie's name?

A. He indicated that he would like to own a farm.

Q. In other words, was the farm purchased for him because he thought if corporate profits were used for the purchase of a farm for you, such profits should be used for the purchase of a farm for him?      A. No, sir.

Q. Were you just being nice to him and gave him a farm?      A. I did not give him a farm.

Q. Is it true that you took approximately eight or ten thousand dollars up to Kansas and applied such money toward the purchase price of Mr. Koyl's farm?      A. I did.

Q. Where did you get the money?

A. From the sale of Gene Clark Plumbing materials.

Q. And was this considered his interest in those [313] materials?      A. It was.

Mr. Machtinger: No more questions, your Honor.

\* \* \* \* \*

### Redirect Examination

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Petitioners' Exhibits for identification 30 and

(Testimony of Gene O. Clark.)

31, I will ask you if you can identify the signatures on those documents?

A. They are mine and my wife's.

Q. And what are these documents?

A. They are a note to the Independent State Bank at Independence, Kansas.

Q. And is that true of both of the documents?

A. It is.

Q. And those are notes for money that you borrowed from the Independent State Bank?

A. It is.

Q. What are the dates of these notes?

A. February the 5th, 1948. [314]

Q. What is the amount of each note?

A. \$14,000 each.

Q. Are we to understand that on that date you borrowed \$28,000 from the Independence Bank at Kansas?

A. That is correct.

Q. Have these notes been paid off?

A. They have.

Q. And when were the final payments made, if you know?

A. I am not sure.

Q. Well, were they made after 1948 or 1949?

A. They were made, I believe, in 1950.

Q. That is, we are referring now to the final payment.

A. Final payment.

\* \* \* \* \*

Q. (By Mr. Alva C. Baird): Those were notes and mortgages on what? [315]

A. On two farms.

(Testimony of Gene O. Clark.)

Q. Where were the farms?

A. We referred to them as the north and south farms.

Q. And those are the farms on which you incurred the operative losses?

A. That is correct.

Q. Now, Mr. Clark, Mr. Machtinger has opened the matter of your entering a plea of nolo contendere in the United States District Court to two counts. Will you relate to the Court the circumstances under which the plea was entered?

Mr. Machtinger: I object to that question.

Mr. Alva C. Baird: Why?

Mr. Machtinger: I will state the reasons. The plea of guilty to the charge of any crime which is a felony can be used for the purpose of impeaching the credibility of a witness. It is my understanding that they do not go to the background of that guilty judgment and they do not go into the facts which lead up to that guilty judgment, and that it is the judgment itself and the fact that the witness or the defendant who was adjudged guilty, it is the fact that he was judged guilty that is used for the purpose of impeaching the credibility of the witness. If counsel will concede that the conviction on the plea of nolo contendere can be used for the purpose of going to the fraud of the petitioners in this case, then, I can see where it may be pertinent to go into the background of that judgment [316] and that plea.



(Testimony of Gene O. Clark.)

The Court: You have urged it for that purpose, haven't you?

Mr. Machtinger: Yes, I have, Your Honor. I have urged it for that purpose.

The Court: I don't think counsel has to concede that your purpose is correct.

Mr. Machtinger: Well, then, I would object to that question and any matters relating to that question unless the Court ultimately decides to our arguments in brief, that the conviction on the nolo plea goes to the issue of fraud in this case.

The Court: Well, I will reserve ruling on this testimony in relation to the particular issue of fraud and intent as distinguished from impeachment until final determination, and in the meantime, permit counsel to question the witness.

Mr. Machtinger: I would have no objection—am I to understand, if the Court decides that the conviction on the plea of nolo contendere cannot be used for the purpose of determining whether or not there was fraud in this case, that these questions will not relate at all to the impeachment aspect of it?

The Court: I see no need of determining that at the moment, Mr. Machtinger, if you want to object to them, especially on that ground, I have no objection to your protecting the [317] record on it. I am going to let this witness explain, subject to motion to strike and to argument on the brief.

Mr. Machtinger: I would like the record to show, then, that respondent objects to any testi-

(Testimony of Gene O. Clark.)

mony relating to the question in issue by counsel, if the judgment and plea of *nolo contendere* is used solely for the purpose of impeaching the credibility of the witness.

The Court: Very well, proceed.

Q. (By Mr. Alva C. Baird): Mr. Clark, before I proceed with the question, will counsel stipulate for the record that the criminal charges against Gene Clark individually or for his individual income tax returns were dismissed by the United States Attorney?

Mr. Machtinger: No, sir, we have made no reference to any criminal charge against Gene Clark for his own income tax.

Mr. Alva C. Baird: Do you deny that fact?

Mr. Machtinger: I am not on the witness stand, I don't think I have to deny anything.

Mr. Alva C. Baird: You may compel me to go to the trouble of getting certified copies of the records, then, if you want to do that, all right.

Q. (By Mr. Alva C. Baird): Mr. Clark, there has been offered in evidence here a certification to the effect that you entered a plea of *nolo* [318] *contendere* on charges of filing or causing to be filed a fraudulent income tax return for Gene Clark, Inc. for the years 1948 and 1949. Now, directing your attention first to the year 1949, I will ask you if you had anything to do with Gene Clark, Inc. at the time fiscal year 1949 came to an end, April 30, 1949, and at the time the return was filed in July, 1949?

A. I did not.

(Testimony of Gene O. Clark.)

Q. Isn't it a fact that prior to that time that you had sold all of your interest in the Gene Clark, Inc. to Archie Koyl?      A. That's right.

Q. The record shows from the return itself that the return was filed by Archie Koyl and Fred Nodds. Now, I will ask you if you gave them any instructions or directions or any help in the preparation of that 1949 return?      A. I did not.

Q. Did you ever see the corporation return prior to the time it was introduced here in evidence in this case?      A. I have not.

Q. Now, coming down to the year 1948 and '49, I will ask you where you were located, where you were residing at the time the indictment was returned against you and brought before the United States District Court here in Los Angeles?

A. I was at Independence, Kansas. [319]

\* \* \* \* \*

Q. When you made your first appearance before Judge Peirson M. Hall in regard to this matter, were you accompanied by counsel?

A. No, sir.

Q. And what instructions did you receive from Judge Hall?

A. He stated that I should go back on my own cognizance and obtain an attorney.

Q. And did you later appear a second time with an attorney?

A. No, sir. I appeared a second time without an attorney.

(Testimony of Gene O. Clark.)

Q. And why had you not observed the Judge's instructions to obtain counsel?

A. I had no money and I couldn't hire one.

Q. And was the reason of your being out of funds the fact [320] that the United States Government in this proceeding pursuant to a jeopardy assessment, had sold out all of your assets and property in Kansas?

\* \* \* \* \*

The Witness: That is correct.

Q. (By Mr. Alva C. Baird): In other words, these farms about which we have been testifying had been sold to satisfy the jeopardy assessment?

A. Not those particular farms, but the one that I had left was.

Q. Now, did you subsequently obtain an attorney? A. Yes, I did.

Q. And that was Mr. Landon Morris?

A. That's correct. [321]

\* \* \* \* \*

Q. What caused you to reach the conclusion that you should enter a plea of nolo contendere?

A. Mr. Landon Morris advised me to do so.

\* \* \* \* \*

#### Recross Examination

Q. (By Mr. Machtinger): Mr. Clark, were you not warned by the District Court Judge who sentenced you, that a plea of nolo contendere could, that even though you plead to nolo contendere, you could be [326] found guilty and sentenced as if you were guilty?

(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: I will stipulate without knowing what was done, that he advised Mr. Clark that the same penalty could be imposed as if he had entered a plea of guilty.

Mr. Machtinger: So stipulated.

Q. (By Mr. Machtinger): Mr. Clark, the corporate books were kept on fiscal years ending on April 30, isn't that correct?

A. That is correct.

Q. Were you not an officer of the corporation and sole owner of the corporation for the period May 1, 1948 until on or about February 4th, 1949?

A. That is approximately right.

Q. And were not the books and records for that period kept under your direction? [327]

\* \* \* \* \*

Q. The last question, Mr. Clark, was whether it was true that until the time you left the corporation approximately February, 1949, the books and records were kept under your direction?

A. They were kept under Freddie Files' direction. [330]

Q. I recognize that Mr. Files was the one who was in charge as comptroller, but was it not true, that he received his orders from you as to what should or should not be placed in the records as to what sales should or should not be recorded, what purchases should or should not be recorded?

A. I have never given Freddie an order as to the corporation's books.



(Testimony of Gene O. Clark.)

The Court: Now, as to this fiscal year ending April 30, 1949, that you are talking about——

Mr. Machtinger: Yes, sir, I am referring to the period between May 1, 1948 and approximately February 1, 1949.

The Court: Well, your methods with respect to unrecorded sales of merchandise weren't any different in that year than they were in the previous years, were they?

The Witness: No, Your Honor.

\* \* \* \* \*

#### Redirect Examination

Q. (By Mr. Alva C. Baird): Mr. Clark, you had nothing to do with the corporation or Freddie Files, or anything to do with the corporation after February, 1949, did you?      A. I did not.

Q. Now, Mr. Clark, will you state whether or not you have any opinion or can give any estimate as to whether the amount [331] of cash which you took from the corporation for the purchase of over-ceiling goods was offset by—and which was not recorded on the books or in the returns, was offset by the excess cost which you had to pay for materials which went to the corporation?

Mr. Machtinger: I object to that question. The question calls solely for a conclusion of the witness not based on any records, not based on any evidence.

The Court: That goes to the weight of it. He can make a statement why he wanted to do it, if he wasn't making a profit, is also perhaps something

(Testimony of Gene O. Clark.)

he might explain. But I will overrule the objection.

The Witness: I always felt that the cost was offsetting the profits and the reason why, Your Honor, I did it, was to dispose of materials that I had in quantity to get those on which I was short. \* \* o \* \*

KENNETH S. STUTZMAN

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name.

The Witness: Kenneth S. Stutzman.

The Clerk: Your address?

The Witness: 4836 North Earl Street, Rosemead.

Direct Examination

Q. (By Mr. Machtinger): What is your occupation, Mr. Stutzman?

A. I am now a collection officer for the Internal Revenue Department.

Q. How long have you been with the Internal Revenue Service?

A. Since December, 1945.

Q. And during the time that you have been with the Internal Revenue Service, have you ever been sent out to audit [333] taxpayers' books and records?

A. I did that almost exclusively from that time until last year, when my title was changed.

Q. And during the time when you were so audit-

(Testimony of Kenneth S. Stutzman.)

ing books and records did you have occasion to call on Mr. Clark of Gene Clark, Inc.?      A. I did.

Q. Was that for the purpose of auditing the tax returns of Gene Clark?

A. It was for the purpose of investigating a complaint letter which had been received in our office, anyway, of an informant's letter.

Q. And did you go to the offices of the Gene Clark, Inc.?      A. I did.

Q. Approximately what month and year?

A. I don't remember what month, but it was in 1949, I believe.

Q. And during the time that you were there, did you examine any books and records of the corporation?      A. Yes.

Q. Did you examine any other books and records?      A. No, I saw no others.

Q. Did you examine any books and records of an organization that was entitled Gene Clark Plumbing Company?

A. No, that was Gene Clark, Inc. [334]

Q. Did you take any books and records with you when you left the office of the Gene Clark Corporation?

A. No, my examination was made at the office.

Q. At whose office?

A. At the Gene Clark office in El Monte.

Q. Did you at any time that you were at that office examining books and records take with you any books and records of any organization?

A. I did not.

(Testimony of Kenneth S. Stutzman.)

Q. Did anyone ever bring to your home any books and records relating to your investigation of Gene Clark?      A. No, sir.

Q. During the time that you——

The Court: Now, let's get it clear. Up to the moment you have been talking about Gene Clark, Inc. Now, did anyone, did you take any records or did anyone deliver any records to your home relating to the individual returns of Gene Clark or his wife or joint returns of Gene Clark and his wife?

The Witness: No records were brought to my home either by myself or any other person or Gene Clark in person, Gene Clark, Inc., or Gene Clark Plumbing.

The Court: All right.

Q. (By Mr. Machtinger): Did Mr. Clark show you while you were at the office of Gene Clark, Inc. any personal records relating to him or his [335] activities?

A. I saw only the payroll records for Gene Clark, Inc.

Q. Did you confer directly with Mr. Clark himself?      A. Yes, at times.

Q. Was he the person who turned over to you the corporate records?

A. I don't remember, I talked with him and also talked with Mr. Koyl. I don't remember which one gave me the corporation books.

Q. Have you ever brought to your home, or do you make a practice of bringing to your home any

(Testimony of Kenneth S. Stutzman.)

records relating to an individual or relating to any entity which you are investigating?      A. No.

The Court: Never mind your practice. Did you bring anything to your home in connection with Gene Clark, Inc., Gene Clark individually, or Gene Clark's wife, or Gene Clark and his wife?

The Witness: The only records that might have been at my home would have been those in my brief case, which would be in the nature of a report to be made the following day upon coming to work.

The Court: Those were your records?

The Witness: That's right.

The Court: Did you take any of the taxpayers' records, corporate or individually? [336]

The Witness: No.

Q. (By Mr. Machtinger): Did Gene Clark or any of his representatives bring any of the tax records, corporate or individual, to your home for examination or for any other purpose?

A. No.

Mr. Machtinger: No further questions.

### Cross Examination

Q. (By Mr. Alva C. Baird): Mr. Stutzman, you mean to say Mr. Clark was never at your home at any time?      A. I didn't say that.

Q. Well, I am asking you, was he?

A. He was in my home, yes, sir.

Q. And was he there on more than one occasion?      A. Yes.



(Testimony of Kenneth S. Stutzman.)

Q. Did you discuss this case with him when he was there?

A. The last time, I did. The first time the subject wasn't connected with income tax.

Q. A subject that wasn't connected with income tax? A. That's right.

Q. What was the occasion of Mr. Clark being at your home?

A. At the time I was interested in raising orchids, and he came up to see the plants that I had. [337]

Q. Well, how long had you been acquainted with Mr. Clark? You are not from Kansas, by any chance, are you?

A. No. Does that make any difference?

The Court: Answer the question.

The Witness: What is the question again, your Honor?

The Court: Read the question.

(The pending question was read by the reporter.)

The Witness: The only way I can answer that question is by making a qualified answer, and that is, I became acquainted with Mr. Clark on my first call at his office at Garvey Boulevard after the examination was completed. It might have been a week, it might have been two weeks, the first time he came to my office. I had known him about two weeks.

The Court: Office or home?

The Witness: Home, that's right.

(Testimony of Kenneth S. Stutzman.)

Q. (By Mr. Alva C. Baird): And then, when did he come to your home again?

A. After he had gone to Kansas. I don't remember that date, it seems about like a year and a half or two years ago he came with an attorney, found me working in my front yard.

Q. Do you know who the attorney was?

A. I don't remember his name, no, sir.

Q. Was the name McVey?

A. That seems familiar, but I don't remember if that was the man or not. [338]

Q. Was he introduced to you as being an attorney from Kansas, Mr. Clark's attorney from Kansas?

A. Yes, sir.

Q. What did Mr. McVey and Mr. Clark come to your home for on that occasion?

A. They wanted some advice on how to proceed in this tax assessment which had been made by other persons.

Q. Well, did they ask you about any records that they were looking for, personal notebooks or anything of that kind that they had been unable to find?

A. They asked about records that I might have had in our own office, which is routine.

Q. Well, did they ask you about any of their own records, and by records, I mean memoranda, books or schedules?

A. No.

Q. Or any papers that were personal papers of Mr. Clark?

A. No.

Q. Did you see any records of Mr. Clark other

(Testimony of Kenneth S. Stutzman.)

than the payroll records of Gene Clark, Inc.?

A. No.

Q. That is the only documents that you saw in connection with this examination?

A. That is the only one I examined. I saw other records in the office.

Q. I mean, that is the only one you looked at?

A. Yes.

Q. Now, as I understand, you went there on an informant's claim? A. That's right.

Q. Who was that informant?

A. I don't know——

Mr. Machtinger: I object.

The Court: Objection sustained.

Q. (By Mr. Alva C. Baird): How long did you work on this case?

A. About three hours one day, and I called back about an hour on another date. It was very brief the last time.

Q. You called back, you mean you went back or you telephoned?

A. I went back in person.

Q. In person. Did you have intermittent conferences on the telephone with Mr. Clark about matters? A. None that I recall. [340]

\* \* \* \* \*

GENE O. CLARK

was recalled as a witness by and on behalf of the petitioners, and, having been previously duly sworn, was examined and testified further as follows: [347]

Direct Examination

Q. (By Mr. Alva C. Baird): Mr. Clark, I will ask you whether or not some time in 1946 you and your wife, Faye Clark, acquired certain farm property in Montgomery County, Kansas?

A. We did.

Q. And what was the nature of that farm; what type of farm was it?

A. That is a grain farm.

Mr. Machtinger: What was that?

Mr. Alva C. Baird: A grain farm.

Q. (By Mr. Alva C. Baird): Wheat and oats?

A. Yes, sir.

Q. Did you produce anything else on that farm?

A. No, sir.

Q. At the time you acquired it—what month did you acquire it in, do you remember?

A. I do not. I believe in September.

Q. To refresh your recollection, was it acquired some time in July, 1946?

A. It was in the summer, it would have been in the warm weather.

Q. Now, at the time you acquired that farm, was there any growing crop on it?

A. No, sir, it wasn't used at that time. [348]

Q. It wasn't in use at that time?

A. That is correct.

(Testimony of Gene O. Clark.)

Q. Now, what did you do in the fall with reference to putting it into use?

A. We planted it to wheat.

Q. You planted the entire farm to wheat?

A. 300 acres.

Q. 300 acres. And how long does it normally take a crop of wheat in that area to mature?

A. We usually combine in July.

Q. In July of the following year? A. Yes.

Q. So that if you planted in October, you would expect to harvest your crop in July of the next year? A. That's correct.

Q. You did not harvest any crop in 1946, then?

A. No, sir.

Q. Now, did you harvest any crop in 1947?

A. No, sir.

Q. Well, you planted a crop in '46, did you not, 300 acres? A. That is correct.

Q. Well, will you explain to the Court why you failed to harvest anything in 1947?

A. That is a bottom farm, that we call down on the river [349] bottom, and it overflowed.

Q. The river overflowed? A. Yes, sir.

Q. Did it destroy the entire crop that you had planted in 1946? A. It destroyed it all.

Q. Did you harvest any of it?

A. Not at all.

Q. Well, then, during the year 1946—or the year 1947, if I understand your testimony, you harvested nothing? A. That is correct.



(Testimony of Gene O. Clark.)

Q. Now, you had some expenditures in connection with that operation, did you not?

A. We did.

Q. Now, do you know with reference to the year 1946 what your expenditures other than such items as might have been capital, as to what they were?

A. They were approximately \$2,000.

Q. Approximately \$2,000. And do you have some checks showing these expenditures?

A. I do.

Q. I will ask you to look at these various checks, and I notice one, October 17, '46, for seed wheat \$100.15, and that is drawn on the special account No. 1.

A. That is correct, signed Clyde R. Clark. [350]

Q. Now, have you examined this group of checks that I have here, and are these the checks that make up the expenditures to which you have referred?

A. They are.

Mr. Alva C. Baird: Would you like to see these, Mr. Machtinger?

Mr. Machtinger: Are you offering them in evidence, Mr. Baird?

Mr. Alva C. Baird: I will offer them in evidence. There is one group of checks.

We would like to offer as Petitioners' Exhibit next in order a group of checks, 23 in number, and running from checks numbering 4602 to 4628, inclusive.

Mr. Machtinger: If the Court please, I object to the admissibility of any of these checks on the

(Testimony of Gene O. Clark.)

ground that a proper foundation for these checks has not been laid, except for the very last check every one of these checks are drawn by someone other than the witness; there is no record to substantiate that any of these checks drawn are for any farm expense of any nature. These are merely a group of checks drawn and signed by one Clyde R. Clark who is not here. We have no basis for knowing what these checks specifically are for other than this witness has said these checks, which allegedly are for some farm expenses. Unless we have Mr. Clyde R. Clark here who can testify, he is the one who drew these checks, if your [351] Honor please, or unless other books which are here substantiate the witness' testimony, I think that these checks are improper for the purpose offered.

The Court: What was the last check you speak of?

Mr. Machtinger: The last check is signed by Gene Clark, just what it is for, I don't know. It is made out, signed by Gene Clark to Clyde R. Clark. It is labeled, "To close account." Or not labeled, there is a notation, "To close account." It is for \$108.89, but what that check is for, I also do not know.

The Court: I certainly don't think any foundation has been laid for these checks, with the possible exception of one, which the witness identified, and now counsel states to me that wasn't signed by him. If you want to establish those checks, Mr. Baird, you will have to take them up one by one

(Testimony of Gene O. Clark.)

and let's see what the circumstances were, if this witness knows.

Mr. Alva C. Baird: All right.

The Court: Please don't lead him on this.

Mr. Alva C. Baird: Very well.

Q. (By Mr. Alva C. Baird): I show you Check No. 4602, and ask you to identify, if you can, what that check is for?

A. That is for Dad's salary.

Q. And your Dad is Clyde Clark?

A. Clyde R. Clark. [352]

Q. Clyde R. Clark. And what was his salary for?

A. That is for working on the farm.

Q. And this is a check for \$450?

A. Yes, sir.

Q. And that is in payment of wages incurred on that farm? A. That is correct.

The Court: For what period?

The Witness: It doesn't state the period.

The Court: Well, you know what period.

The Witness: No, your Honor.

The Court: Did you have any other farm at that time?

The Witness: No, your Honor.

The Court: Only the one?

The Witness: Yes, sir.

The Court: What salary, or what salary basis, do you claim that you paid your father?

The Witness: \$50 a week.

Mr. Machtinger: \$50 a week?

(Testimony of Gene O. Clark.)

The Witness: Yes, sir.

The Court: All right, go ahead, Mr. Baird.

Q. (By Mr. Alva C. Baird): I show you 4603——

The Court: Better offer these checks one by one.

Mr. Alva C. Baird: I will offer No. 4602, Petitioners' [353] exhibit next in order.

Mr. Machtinger: I object to the admission of the check as evidence. It is not drawn by the witness, it is signed by Clyde R. Clark, made out in favor of Clyde Clark.

The Court: All right, I will sustain you up to the moment, I will give him a chance to explain further, if he can.

Q. (By Mr. Alva C. Baird): Mr. Clark, was your father, Clyde R.——

The Court: Don't lead him, please.

Mr. Alva C. Baird: Very well.

Q. (By Mr. Alva C. Baird): Will you state who was authorized to draw checks on Special Account No. 1 of Gene Clark, Inc.?

The Court: Of Gene Clark, Inc., was this?

The Witness: Gene Clark, Inc., Special Account No. 1. Clyde R. Clark was, and I was.

Q. (By Mr. Alva C. Baird): Was anyone else?

A. I don't know of anybody else.

Q. During this period of time, do you know whether anyone else was?

A. I don't believe they were.

The Court: Then, this is a check of Gene Clark,

(Testimony of Gene O. Clark.)

Inc., and not of this witness at all, is that correct?

Mr. Alva C. Baird: It is a check on an account [354] labeled Gene Clark, Inc., Special Account No. 1.

The Court: All right, it wasn't Gene Clark, Inc. account, was it?

The Witness: It was Gene Clark, Inc., and I borrowed it, it was Gene Clark, Inc. account No. 1, and I had borrowed the \$5,000 to deposit.

Mr. Alva C. Baird: I will say to your Honor that we will connect up that \$5,000. It is already referred to in Petitioner's Exhibit 19 on the ledger sheet, and it is also, I believe, reflected in the bank account, which we will have here.

Q. (By Mr. Alva C. Baird): Now, coming back now to Check No. 4602, directing your attention to the notation down in the bottom, "Salary," do you know whose writing that was?

A. That is Dad's, Clyde R. Clark's.

Q. Clyde R. Clark's. Will you state what this check was for?

A. That is for nine weeks' salary.

Q. For nine weeks' salary?

A. That's correct.

Q. Was your father engaged by you?

A. That's correct.

Q. Wait a minute. To do any other service or work other than on the farm? [355]

A. Just the farm.

Q. Just the farm.



(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: We offer the check, your Honor.

Mr. Machtinger: May I see the check? Is this the same check that was just offered before?

The Witness: Yes.

Mr. Machtinger: If the Court please, I again object to the admissibility of this check. There is nothing except the self-serving word "salary" to indicate this check is for salary, there is no proof here that the check was drawn for that purpose, other than the word "salary" that was written by the same person who drew the check in his own favor. The witness has not established by any other source that is here in the courtroom that there were any expenditures necessitated at that time for salaries.

The Court: Well, Mr. Machtinger, I am going to let it in just to move along. As far as I am concerned, up to the moment, unless it is connected up a great deal further than it is now, I am not impressed with its probative force. Mr. Baird has said he is going to follow it up, and it will be subject to motion to strike consideration later.

Now, I might add that if there are any more bunches of checks brought in here on this farm situation to indicate expenditures, I would like to have some advance announcement as to whether they are for Dad or some other member of the family [356] before they are offered in a lump.

Mr. Machtinger: In the interest of time, if your Honor please, I reserve the right to object to each

(Testimony of Gene O. Clark.)

of these checks until they are all testified to, or would you prefer——

The Court: You do it in your own way. If you want to have each one of them identified, which, as I understand it, you did, all right; if you don't, say so, I can't tell by looking at them, and certainly there is enough indication already that by the fact of who drew them, who they were drawn on, whose account it was, and so forth, to indicate that they might be subject to some inquiry.

Mr. Machtinger: I think it is essential that each one of these checks be identified individually. My only thought was that in the——

The Court: I am not going to take a bulk objection to these checks. You will have to object to each one.

Mr. Machtinger: Yes, sir.

The Clerk: Petitioners' Exhibit 32 admitted in evidence.

(Petitioners' Exhibit No. 32 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you a check No. 4605, for \$102.15, and ask you if you know what that check is for? [357]

A. That check is for seed wheat.

Q. And how do you determine that?

A. It so states in the description.

Q. Do you know whose writing that description is in? A. I do not.

Mr. Alva C. Baird: Mr. Machtinger, we offer this as Petitioners' Exhibit next in order.

(Testimony of Gene O. Clark.)

Mr. Machtinger: If the Court please, I object to the admission of this check in evidence; the witness states that the only way he knows that is for the seed wheat, because the check in the description says for seeding wheat; the witness states he does not know whose writing it is, it is a hearsay document and I think improper evidence in this matter.

The Court: Well, I am inclined to agree with you, but I am still going to take it subject to motion to strike or subject to being followed up or both.

The Clerk: Petitioners' Exhibit 33 admitted in evidence.

(Petitioners' Exhibit No. 33 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you a check No. 4606 dated October 17, 1946——

The Court: Let me ask you, do I understand all of these checks were in the hands of your agent?

Mr. Machtinger: I believe that one of our men may have looked at every one of these checks.

Mr. Alva C. Baird: That is correct, your Honor, they spent a day or two days or more in my office going over these checks.

The Court: All right, go ahead.

Q. (By Mr. Alva C. Baird): Will you identify that check, and tell us, if you can, what it was for?

A. For seed wheat.

Mr. Alva C. Baird: We offer this as petitioners' exhibit next in order.

(Testimony of Gene O. Clark.)

Mr. Machtinger: If your Honor please, this check is identical with the previous check. I move on the same basis that——

The Court: Who wrote the words “seed wheat” on this one, if you know?

The Witness: I do not know.

The Court: All right, same ruling.

The Clerk: Petitioners' Exhibit 34 admitted in evidence.

(Petitioners' Exhibit No. 34 was marked for identification and received in evidence.)

The Court: I might also, subject to being followed [359] up, that one of the reasons I am ruling this way, if I ruled them out, we would have an offer of proof that would be twice as long as letting them in. I am trying to be practical about it. Go ahead.

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check 4607, dated October 25th, 1946, and ask you, if you can, to tell us what that is.

A. That is \$50 for a salary.

Q. And is that check, and the others to which I have referred, have they been signed by Clyde R. Clark, your father? A. That's right.

Q. Do you know who wrote the pencil notation, salary or labor or whatever it is up here on this check?

A. I believe Joe Acre, the accountant, did that.

Mr. Alva C. Baird: We offer No. 4607 as petitioners' exhibit next in order.

Mr. Machtinger: If the Court please, I object

(Testimony of Gene O. Clark.)

to it on the same grounds as the previous checks, it is drawn by Clyde R. Clark in favor of Clyde R. Clark. There is a word in the description which is identified as salary, it may be salary, but it certainly is not in the same writing as Clyde R. Clark's handwriting. There is no foundation laid that this is a proper check.

The Court: I agree that the witness shows no personal knowledge of it at all, but I am going to let the same ruling [360] apply.

The Clerk: Petitioners' Exhibit 35 admitted in evidence.

(Petitioners' Exhibit No. 35 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check No. 4608, bearing date, apparently, October 1st, 1946, it is rather blurred and I can't be sure of it, in the amount of \$50 to Clyde R. Clark, and ask you if that was drawn by Clyde R. Clark, your father? A. It was.

Q. And is that the amount of weekly salary that he was being paid? A. It was.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

Mr. Machtinger: I object to the admission of this check on the same basis as previously——

The Court: Is the word "salary" on there?

Mr. Machtinger: No, sir, there is nothing on this check to identify it for any express purpose.

The Court: Do you have any recollection of that check individually, Mr. Clark?



(Testimony of Gene O. Clark.)

The Witness: I do not. [361]

The Court: Very well, same ruling.

The Clerk: Petitioners' Exhibit 36 admitted in evidence.

(Petitioners' Exhibit No. 36 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check No. 4609, dated October 18, 1946, payable to Clyde R. Clark, in the amount of \$50, and ask you if that was drawn by Clyde R. Clark on that account? A. It was.

Q. And I notice the notation in the upper left-hand corner, will you tell us what that is and whose writing that is in, if you know?

A. It says "salary", I think that is Joe Acre's writing.

Q. Joe Acre was the accountant?

A. Joe Acre was the accountant.

Mr. Alva C. Baird: We offer that as Petitioners' exhibit next in order.

Mr. Machtinger: If the Court please, I object to the admission of this check on the same grounds as the prior checks.

The Court: Same ruling.

The Clerk: Petitioners' Exhibit 37 admitted in evidence. [362]

(Petitioners' Exhibit No. 37 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4610 dated November 2, 1946, in the amount of \$21 and ask you by whom that check was drawn and

(Testimony of Gene O. Clark.)

call your attention to the notation in the upper left-hand corner, tell us if you can, identify the writing.

A. That is drawn to the North End Service Station, Gas and Oil, for October.

Q. Do you know in whose writing that check is?

A. Yes, sir, Dad's writing, Clyde R. Clark.

Q. Is the notation on the upper left-hand corner in your father's writing, or do you know?

A. It is.

Mr. Alva C. Baird: I offer it as petitioners' exhibit next in order.

Mr. Machtinger: I object to the admission of this check, if the Court please, there is nothing to connect this check with any farm expenses; the witness has not stated that he personally has any knowledge of the gas for which this check was issued.

The Court: Same ruling.

The Clerk: Petitioners' Exhibit 38 admitted in evidence. [363]

(Petitioners' Exhibit No. 38 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4612, dated November 8, 1946, payable to Clyde R. Clark for \$50 and drawn by Clyde R. Clark and ask you if you know what that was for?

A. It doesn't state in the description what it is for, I can only say that as was normal, \$50 a week salary, if that is it.

Mr. Alva C. Baird: We offer that as the petitioners' next in order.

(Testimony of Gene O. Clark.)

The Court: Same objection; same ruling.

The Clerk: Petitioners' Exhibit 39 admitted in evidence.

(Petitioners' Exhibit No. 39 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you a check, No. 4613, dated November 15, 1946, in the amount of \$50, payable to Clyde R. Clark, drawn by Clyde R. Clark on this Special Account No. 1, and ask you if you know what that check was for?

A. \$50, which is his weekly salary, and I would take it to be that. [364]

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 40 admitted in evidence.

(Petitioners' Exhibit No. 40 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4614 in the amount of \$195.57, bearing date in pencil "11/9/1946" and ask you to whom that check was issued, and if you know, for what purpose it was issued?

A. W. A. Thompson, for seed wheat and oats.

Q. Do you know in whose handwriting the check is?

A. That is in Dad's handwriting, Clyde R. Clark.

Q. Is the notation on the upper left-hand corner

(Testimony of Gene O. Clark.)

“for seed wheat and oats”, can you tell us in whose handwriting that is?

A. Yes, that is Dad’s, Clyde R. Clark.

Mr. Alva C. Baird: We offer that as petitioners’ exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners’ Exhibit 41 admitted in evidence. [365]

(Petitioners’ Exhibit No. 41 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4615, dated November 22nd, 1946, for the sum of \$50, payable to Clyde R. Clark, and drawn by Clyde R. Clark, and ask you if you know what that check was for?

A. That is for \$50, and I would take it to be his salary.

Mr. Alva C. Baird: We offer that as petitioners’ exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners’ Exhibit 42 admitted in evidence.

(Petitioners’ Exhibit No. 42 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4616, can you tell us what date that check was issued?

A. March 29.

Q. Is that March or November?

A. November.

Q. Of what year?

A. Of 1946.

(Testimony of Gene O. Clark.)

Q. And do you know in whose handwriting the entire check [366] is?

A. It is in Dad's, Clyde R. Clark's handwriting.

Q. Is the check payable to him and drawn by him on the Special Account No. 1?

A. That is correct.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: What is the amount of that check?

Mr. Alva C. Baird: \$50, your Honor.

Q. (By Mr. Alva C. Baird): Do you know what it is for? A. I take it to be a salary.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 43 admitted in evidence.

(Petitioners' Exhibit No. 43 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4617, dated December 6, 1946, payable to Clyde R. Clark for \$50 and drawn by Clyde R. Clark on Special Account No. 1. I will ask you if you know to whom the check was issued? [367]

A. It is \$50 and I take it to be Dad's salary.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 44 admitted in evidence.



(Testimony of Gene O. Clark.)

(Petitioners' Exhibit No. 44 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4618, dated December 6, 1946 in the amount of \$36.50, and I will ask you in whose handwriting does this check appear to be, and particularly, can you identify the handwriting in the upper left-hand corner?

A. It's in Clyde R. Clark's handwriting and it's for repairing fences.

Q. The notation "repairing fences, South Farm"—

A. That is correct.

The Court: To whom is it payable?

The Witness: Payable to Clyde R. Clark.

The Court: Do you have personal knowledge of what it is about?

The Witness: I do not.

Mr. Alva C. Baird: We offer this as petitioners' exhibit next in order. [368]

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 45 admitted in evidence.

(Petitioners' Exhibit No. 45 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4619 dated December 6th, 1946, in the amount of \$590.36, payable to A. M. Eckleberry, co-treasurer, and I will ask you if you know what that check was for?

A. That is for taxes.

Q. And for taxes to what?

A. On the farms.

(Testimony of Gene O. Clark.)

Q. On the farms that you owned in Montgomery County, Kansas?      A. I owned one of them.

Q. You owned one of them?

A. That is correct.

Q. And this check is to cover the taxes on more than one farm?      A. It is.

Q. Now, will you explain that, please, what farms are we now talking about?

A. Dad paid the taxes on both the North and South Farms.

Q. On both the North and South Farms? [369]

A. That is on both my farm and Archie Koyl's farm.

Q. Well, now, if I understand it, this check, then, is in payment of taxes on two different pieces of property in Montgomery County, Kansas. Now, will you state again, just so we will have the record clear, whether or not this involved more than one farm?

A. It involves two farms, both my farm and Archie Koyl's farm.

Q. Do you know how this amount of \$590.36 was to be allocated as between the two farms?

A. We were to each pay our proportionate share, both Archie and I.

Q. Well, do you know what your proportionate share was?      A. At this time I do not.

The Court: You don't know how much tax was on either farm, do you?

The Witness: No, I don't.

Mr. Alva C. Baird: I offer this as petitioners'

(Testimony of Gene O. Clark.)

exhibit next in order. We may be able to clear that up.

Mr. Machtinger: I object.

The Court: Objection sustained.

Mr. Alva C. Baird: May I have that marked for identification purpose, your Honor?

The Clerk: Petitioners' Exhibit 46 marked for identification. [370]

(Petitioners' Exhibit No. 46 was marked for identification.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4620 dated December 13, 1946, payable to Clyde R. Clark in the amount of \$50, drawn by Clyde R. Clark, and ask you if you know what that was?

A. I take it to be a salary.

Q. To your father? A. That's correct.

Mr. Alva C. Baird: We offer that as Petitioners' exhibit next in order.

Mr. Machtinger: Same objection.

The Court: Same objection as with respect to those others and the tax check.

Mr. Machtinger: Yes, sir.

The Court: Same ruling.

The Clerk: Petitioners' Exhibit 47 admitted in evidence.

(Petitioners' Exhibit No. 47 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4621 dated January 31st, 1947, payable to Clyde R. Clark—this goes to '47.

I will withdraw that last, because my associate

(Testimony of Gene O. Clark.)

called my [371] attention to the fact that it relates to '47. I do not want to get into '47 at this moment.

I show you Check 4603 dated October 11, 1946, payable to Clyde R. Clark for \$50 drawn by Clyde R. Clark on the Special Account No. 1, and ask you if you know what it was for?

A. That is for salary, advance salary.

The Court: You mean, you assume that from the amount of the check?

The Witness: That is written on it.

The Court: By whom?

The Witness: By apparently Joe Acre, the auditor.

The Court: And that is the only reason that you have to say that it is salary then, that it's the amount of salary which your father was drawing?

The Witness: That's right.

The Court: All right, same objection, same ruling.

The Clerk: Petitioners' Exhibit 48 admitted in evidence.

(Petitioners' Exhibit No. 48 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): Mr. Clark, may I ask you whether or not any of the items on the checks which have been introduced in evidence here with reference to this farm, were those items included as [372] deductions on your return for 1946?

A. They were not?

Q. Now, with reference to the year 1947, I will

(Testimony of Gene O. Clark.)

direct your attention to a trip that you made to Kansas some time that year.

Mr. Machtinger: Excuse me for interrupting, if the Court please, if counsel is through with the year 1946, are you going to put on any more about '46?

Mr. Alva C. Baird: I think there might be something that might tie in '46 a little bit, and I would like to keep that open until we have disposed of '47.

Mr. Machtinger: I would like to make it clear we do not waive our rights in regard to the testimony. With the Court's permission, if we can wait until counsel has the opportunity to introduce any more supporting evidence, if he cares, in the year 1946.

The Court: Well, I don't understand you are waiving anything.

Mr. Machtinger: Well, it is understood I do not waive the right to strike.

Q. (By Mr. Alva C. Baird): Mr. Clark, you did make the trip back to Kansas some time this year, did you not?      A. I did.

Q. I will ask you whether or not while you were there you [373] made any inquiry of your accountant, Mr. Joe Acre, I believe you have stated his name was, about any memoranda or data that he had with reference to your farming transactions back in these years, '46, '47, '48, and '49?

A. I did.

Q. And I will ask you what you did with reference to whether or not you obtained any data or



(Testimony of Gene O. Clark.)

information from him at that time? I will stop there. A. I did not.

Q. Will you state whether or not you obtained any data or other information from him subsequent to your return to California?

A. Yes, he mailed it to me.

Q. And about when was that mailed to you?

A. The latter part of October—or February.

Q. Latter part of February of this year?

A. This year.

Q. 1955? A. Correct.

Q. Now, I show you petitioners' proposed exhibit next in order—maybe we had better have that marked for identification.

The Clerk: Petitioners' Exhibit 49 marked for identification. [374]

(Petitioners' Exhibit No. 49 was marked for identification.)

Q. (By Mr. Alva C. Baird): I show you Petitioners' Exhibit 49 for identification, and ask you where that came from?

A. That came from Mr. Joe Acre.

Q. When?

A. In February, 1955, this year.

Q. And will you state how Mr. Acre came to send that document to you?

A. Yes. I requested that he send all of the papers pertaining to the farms to me.

Q. And was this particular schedule, Petitioners' Exhibit for identification No. 49, part of the papers that he sent you? A. It was.

(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: Do you have a copy of this, Mr. Machtinger?

Mr. Machtinger: Yes.

Mr. Alva C. Baird: I will say to the Court, that this purports to be an income tax schedule.

The Court: Let me look at it. Did you prepare this yourself?

The Witness: No, your Honor, Joe Acre did.

The Court: As far as you know he did, but do you have [375] any information about it except that it was mailed to you by Joe Acre?

The Witness: Yes, there is some information about it.

The Court: Well, what is the information, Mr. Baird?

Mr. Alva C. Baird: I am trying to find out, your Honor, if you will bear with me just a moment.

If your Honor please, there is no information other than that Mr. Acre did send a small envelope containing that document, and I don't know whether he had these checks.

The Court: What is your position, Mr. Machtinger?

Mr. Machtinger: Do I understand you have offered this in evidence?

Mr. Alva C. Baird: Not at the moment. I have had it marked for identification.

The Court: I thought you were offering it.

Mr. Alva C. Baird: We offer this, if your Honor please, in evidence, as being a statement coming from a certified public accountant employed by Mr.

(Testimony of Gene O. Clark.)

Clark for the purpose of keeping an account of expenditures on his farm operations.

The Court: Will you give your authorities in support of its admissibility?

Mr. Alva C. Baird: I think I have all the authority now that I will ever have.

Mr. Machtinger: If the Court please, I object to the admission of this document. [376]

The Court: Objection sustained.

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check No. 4621, dated January 3, 1947, payable to Clyde R. Clark and in the amount of \$50 and drawn on the special account by Clyde R. Clark, and ask you if you know what that was for?

A. I would judge it to be a salary check.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

Mr. Machtinger: If the Court please, I object to the admission of this check, it is a check drawn by Clyde R. Clark and in favor of Clyde R. Clark, there is no substantiating evidence and there has been no proper foundation laid for the introduction of this document.

The Court: It's drawn on——

Mr. Machtinger: By Clyde R. Clark on the Gene Clark, Inc. bank account in favor of Clyde R. Clark.

The Court: Same ruling. That is, the same ruling as with respect to previous checks in 1946.

The Clerk: Petitioners' Exhibit No. 50 admitted in evidence.

(Testimony of Gene O. Clark.)

(Petitioners' Exhibit No. 50 was marked for identification and received in evidence.) [377]

Q. (By Mr. Alva C. Baird): I show you Check 4622, dated January 6, 1947, in the amount of \$85, drawn by Clyde R. Clark, and ask you if you can tell me to whom the check is made payable?

A. E. Pinchner, it is for overhauling, in the description it states "Overhauling the truck," \$85.

Q. Do you know in whose handwriting this "Overhauling truck, \$85" is?

A. That is in Dad's handwriting.

Q. And do you know what truck this would relate to? A. I would not.

Q. Do you know whether or not on this farm that you had any trucks?

A. I did, I had two trucks.

Mr. Alva C. Baird: We offer this as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 51 admitted in evidence.

(Petitioners' Exhibit No. 51 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4623, dated January 17, 1947 for \$50 payable to Clyde R. Clark, drawn by Clyde R. Clark on Special Account No. 1, and ask you if you can identify that? [378]

A. I would take it to be a salary.

Mr. Alva C. Baird: We offer petitioners' exhibit next in order.

(Testimony of Gene O. Clark.)

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 52 admitted in evidence.

(Petitioners' Exhibit No. 52 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4624 dated January 10, 1947, payable to Clyde R. Clark in the amount of \$50, drawn by Clyde R. Clark, and ask if you can identify that?

A. I would take it to be a salary.

Mr. Alva C. Baird: We offer it as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 53 admitted in evidence.

(Petitioners' Exhibit No. 53 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4627 dated January 24, 1947, payable to Clyde R. Clark in the amount of \$50, drawn by Clyde [379] R. Clark on Special Account No. 1, and ask if you can identify it?

A. I would take it to be a salary.

Mr. Alva C. Baird: We offer it as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 54 admitted in evidence.

(Petitioners' Exhibit No. 54 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check



(Testimony of Gene O. Clark.)

No. 4628, dated March 26, 1947 in the amount of \$187.89, payable to Clyde R. Clark and drawn by Gene Clark on Special Account No. 1, and ask you if you can tell us what that check was for?

A. In the description it states "To close account."

Q. Do you know whether——

The Court: Don't lead him on it.

Q. (By Mr. Alva C. Baird): What was the proceeds of this check used for, if you know?

A. It is my opinion it was deposited. I take that by Joseph Acre's note.

Q. Can you identify the endorsement on the back of the [380] check?

A. Endorsement is Clyde R. Clark.

Q. Clyde R. Clark.

Mr. A. Baird: Would your Honor pardon me a minute?

Q. (By Mr. A. Baird): Mr. Clark, can you tell us whether or not an account was opened in Independence, Kansas, at or about this time?

A. That is March 26th, 1947?

The Court: Mr. Baird, you are certainly not contending that is an expense check, are you?

Mr. A. Baird: Not up to the moment, your Honor. I am trying to find out what it is.

The Court: All right. Suppose a bank account was opened in Independence and suppose this went into it. Wouldn't you have to prove what came out of it as a basis for the expenses?

Mr. A. Baird: I think that I would, but it—

(Testimony of Gene O. Clark.)

I know that I would have to get it as an expense check, but I am trying to determine whether or not this ties in in any way with other information we had.

The Court: Go ahead.

Mr. A. Baird: May I have this marked for identification? I may be able to make some use of it later.

The Clerk: Petitioners' Exhibit 55 marked for identification. [381]

(The document above referred to was marked

Petitioners' Exhibit No. 55 for identification.)

Mr. A. Baird: Will you mark this for identification, please.

The Clerk: Petitioners' Exhibit 56 marked for identification.

(The document above referred to was marked

Petitioners' Exhibit No. 56 for identification.)

Mr. A. Baird: Mr. Machtinger, you have seen this, have you not?

Mr. Machtinger: Yes.

Q. (By Mr. A. Baird): Mr. Clark, I show you what appears to be an official statement from the Office of the County Treasurer in Montgomery County, Kansas, dated December 3, 1947, and ask you if you can tell us what that is, if you know what property that relates to?

A. Yes, the "Sycamore Township" denotes it is the North Farm.

Q. Now, who owns the so-called North Farm?

A. That was my farm.

(Testimony of Gene O. Clark.)

Q. Was that the farm about which you have been testifying here this afternoon?

A. That is correct. [382]

Q. Can you determine from looking at that document what the amount of taxes for 1947 were?

A. The total is \$223.24.

Mr. A. Baird: We offer that, if your Honor please, as an indication that there was received from Gene O. Clark by the Office of the County Treasurer, Montgomery County, Kansas, taxes in the amount of \$223.24. The witness has stated that relates to the so-called North Farm.

The Court: Is that a bill or a receipt?

Mr. A. Baird: It has marked on the top "Received of Gene O. Clark, \$223.24."

The Court: Does it give the date?

Mr. Machtinger: It says the date is December 3rd, 1947. According to this document, if the Court please, it does not specifically state, to my knowledge, what is set forth and do not understand counsel to say he has a check which purports to be in payment of this notice, if it is such.

Mr. A. Baird: I do not think we have a check, but I will find out.

No, we do not have a check.

The Court: Well, do you know whether you paid these taxes, Mr. Clark?

The Witness: Dad would have paid those, Clyde R. Clark.

The Court: Out of what? [383]

The Witness: Out of the bank account.

(Testimony of Gene O. Clark.)

The Court: What bank account?

The Witness: No doubt be the bank account, Independence State Bank of Independence, Kansas.

The Court: In whose name?

The Witness: In Gene Clark or Clyde R. Clark.

The Court: No incorporated?

The Witness: No, sir.

The Court: Are you offering it, Mr. Baird?

Mr. A. Baird: Yes, I am.

Mr. Machtinger: I understand that counsel is offering it merely to show that there was received of Gene R. Clark, Eugene Clark, the sum set forth on that document as disclosed by the document and nothing more.

The Court: Then I will overrule any objection to this.

Mr. Machtinger: I have no objection, if it is offered solely for that purpose.

The Court: Well, I don't see any need to limit it. It may go to materiality if it is followed up, but, as far as I can see, it is at least admissible in evidence. If there is any evidence that would indicate that somebody else was paying for it, that might be in rebuttal.

The Clerk: Petitioners' Exhibit 56 admitted in evidence. [384]

(The document above referred to heretofore marked Petitioners' Exhibit No. 56 for identification was received in evidence.)

Mr. A. Baird: Now, if the Court please, I renew my offer as to check No. 4619 which has been

(Testimony of Gene O. Clark.)

marked for identification as Petitioners' Exhibit 46, which is the check to the County Treasurer of December 6, 1946, \$590.36, and I will offer it for the purpose of showing that the taxes on this property would be in substantially the same amount as appears on the 1947 receipt a year later, and that we should—it would be fair, it seems to me, and not unreasonable, to make an allocation of that amount of this \$590.36 check that Gene Clark expended.

Mr. Machtinger: If the Court please, I object to the admission of this document. There is nothing whatsoever offered to connect this check with the exhibit introduced by the Petitioner indicating that there was at one time, apparently, a payment to the County Assessor. This is a check made out to Mr. Eckleberry, County Treasurer. There is no indication what it is for. There has been testimony that it may have been on behalf of a third party. There is nothing to indicate how much of it would relate to this Petitioner, if at all, for farm expenses, if there were such expenses.

The Court: I will overrule the objection subject to motion to strike and argument in the brief.

The Clerk: Petitioners' Exhibit 46 admitted in [385] evidence.

(The document above referred to heretofore marked Petitioners' Exhibit No. 46 for identification was received in evidence.)

Mr. A. Baird: That is all of this witness on direct.

Mr. Machtinger: At this time, your Honor, Re-



(Testimony of Gene O. Clark.)

spondent would respectfully move the Court to strike all the check exhibits introduced by Petitioner as not having had a proper foundation laid for admissibility.

The Court: I think you have protected your record sufficiently on that. The rulings will remain as they are up to the moment, which reserves the right to move to strike and to argue in the brief.

Mr. A. Baird: May I ask one further question I neglected to ask?

Q. (By Mr. A. Baird): Mr. Clark, with reference to the year 1947, do you know what——

The Court: Just a minute. Mr. Bryant, you had better wait just about a minute. I was coming around to ask for some information.

Go ahead, Mr. Baird.

Q. (By Mr. A. Baird): Do you know what the expenditures were in the operation [386] of your farm in Montgomery County, Kansas, in 1947?

A. They were approximately \$9,000.

Q. Approximately \$9,000. Now, was any part of that expenditure included in your 1947 return?

A. It was not.

Q. Now, will you explain to the Court how you could have had deductible expenditures of approximately \$9,000 in the year 1947 and not have had it included in your 1947 return?

Mr. Machtinger: I object to that. I think it is drawing an inference.

The Court: I will sustain the objection. I don't know what these \$9,000 expenses were. I do know

(Testimony of Gene O. Clark.)

that the witness, less than a half an hour ago, had a look at a paper which an accountant had mailed which had some such figure in it as a sum total for certain detailed items; whether that was suggestive of the amount in his mind or not, I don't know, but certainly nothing further in that has been said.

Mr. A. Baird: Well, do I understand the Court ruled against his answering the question?

The Court: As put, yes. I don't know whether you have any other questions or not. I am inclined to think that we might recess at this point. [387]

\* \* \* \* \*

### Cross Examination

Q. (By Mr. Machtinger): Mr. Clark, isn't it a fact that except for the descriptive notations on the checks that were handed to you, you have no personal knowledge as to what those checks were drawn for?

A. The \$450, I knew what it was. Dad had drawn that salary for some weeks. I knew about it. The others, I wasn't there; I do not know, you are right.

Q. And isn't it also a fact that you did not know of your own personal knowledge what use was made of the proceeds of those checks?

A. That is correct.

Q. Isn't it also a fact, Mr. Clark, that, except for the— [396] strike that sentence.

Mr. Machtinger: That is all the questions we have.

The Court: Is your father living, Mr. Clark?

(Testimony of Gene O. Clark.)

The Witness: Yes.

The Court: Where?

The Witness: Elk City, Kansas.

The Court: How old is he?

The Witness: 74.

The Court: All right. [397]

\* \* \* \* \*

[Endorsed]: Filed May 3, 1955.

---

[Title of Tax Court and Docket Nos. 48336-7-8.]

## PROCEEDINGS

Los Angeles, California, March 29-30, 1955

\* \* \* \* \*

### DONALD E. PHILLIPS

was called as a witness by and on behalf of the Respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Donald E. Phillips, 1373 South Ridgeley Drive, Los Angeles.

### Direct Examination

Q. (By Mr. Machtinger): Will you state your occupation, Mr. Phillips?

A. I am now a public accountant.

Q. Are you licensed by the State of California?

A. I am.

Q. What background have you had for the pur-

(Testimony of Donald E. Phillips.)

pose of [156] preparation; what preparation have you had for your accounting career?

A. I attended Los Angeles Junior College from 1937 to 1938, Woodbury College from 1939 to 1940, and obtained a degree in accountancy at Woodbury College. Worked for Lockheed Aircraft Corporation as an accountant, United States Army in the supply division, and for the Bureau of Internal Revenue from 1946 until 1943 as an internal revenue agent.

Q. Do you mean from 1946 to 1953?

A. 1953, yes.

Q. What was your position with the Bureau of Internal Revenue?

A. Internal revenue agent, field examiner.

Q. In the course of your occupation with the Bureau of Internal Revenue, did you have occasion to audit the books of taxpayers in order to determine whether or not their income had been properly reported on their returns?

A. Individuals, partnerships, and corporations, yes, sir.

Q. Was that the main bulk of your work?

A. Yes, sir.

Q. While you were employed with the Internal Revenue Service, did you have occasion to audit the books and records of the Gene Clark, Inc. corporation? A. Yes, sir, I did.

Q. Approximately in what year did you start such work? [157]

A. In 1950, approximately September 1950.

(Testimony of Donald E. Phillips.)

Q. In connection with such audit, did you examine all the books and records of the corporation?

A. Yes, sir, I did.

Q. Approximately how long a time did you work in connection with this audit?

A. My final report was submitted in February of 1953, so it covered a period of almost three years.

Q. And in the course of that audit, did you also have occasion to go into the tax returns of Archie and Fawn Koyl?

A. Yes, I did.

Q. In connection with the tax liability of Archie and Fawn Koyl, did you examine their income tax returns for the calendar years 1946, '47, '48 and '49?

A. Yes, sir, I did. [158]

\* \* \* \* \*

Q. In the course of your investigation of the tax liability of Gene Clark, Incorporated and of the tax liability of the stockholders of that corporation, did you prepare a schedule showing the distribution of unreported constructive dividends to the taxpayers?

A. Yes, sir, I did.

\* \* \* \* \*

Q. I hand you Respondent's Exhibit G marked for identification. Is this the exhibit that you prepared showing the distribution of unreported constructive dividends?

A. It is. [161]

\* \* \* \* \*

Q. Did you examine the books and records of the Gene Clark, Inc. corporation for the fiscal years ended April 30, 1947, April 30, 1948, April 30, 1949,



(Testimony of Donald E. Phillips.)

and April 30, 1950?      A. Yes, sir, I did. [162]

Q. Did you examine the income tax returns as filed by the corporation for those years?

A. Yes, sir, I did.

Q. In the course of your investigation and examination of the books and records of the corporation, did you attempt to determine whether or not the income as reported on the income tax returns was correct?      A. Yes, sir, I did.

Q. As a result of the examination of the books and records of the corporation, did you arrive at an adjustment to net income of the corporation?

Mr. Campbell: Objected to as immaterial.

The Court: Well, I will overrule the objection as to whether he arrived at an adjustment. But when the question is asked as to what the adjustment is, I will sustain the objection.

Q. (By Mr. Machtinger): Can you explain what you did in the course of arriving at an adjustment of net income to the corporation, starting with the fiscal year April 30, 1947? [163]

\* \* \* \* \*

The Witness: I made a detailed analysis of the bank records of the corporation; that is, all items deposited into the bank accounts, various bank accounts of the corporation, were examined from the original bank deposit slips on file at the various banks. These items of bank deposits were compared to the cash receipts records of Gene Clark, Incorporated in order to verify whether or not all of the

(Testimony of Donald E. Phillips.)

income items were reported. Upon analysis of these records for the four years involved——

Mr. Campbell: I am going to object to his conclusions or what he found. As I understand it, he is confined to what he did.

The Court: Well, he told what he did now. The bank statements aren't in evidence, so that I don't know what they are. I don't know whether they are here or not. I don't know whether the records are here. I assume they are—as to what the books showed as to receipts. But the basis of comparison, so far as I know, isn't here. [164]

Q. (By Mr. Machtinger): In the course of your examination of the corporate records for the fiscal year ended April 30, 1947, did you examine the contract sales of the corporation as disclosed on the books and records?

A. Yes, sir, I did.

Q. Did you examine the tax return filed by the corporation for the fiscal year ended April 30, 1947 with respect to the contract sales, as disclosed by the tax return?

A. Yes, sir, I did.

Q. Did the contract sales, as set forth on the tax return, correspond with the contract sales as set forth on the books and records of the corporation?

Mr. Campbell: Objected to as calling for his conclusion. No proper foundation laid, and immaterial to the issues here.

The Court: Overruled. Answer the question.

(Testimony of Donald E. Phillips.)

A. Yes, sir, they were the same.

Q. (By Mr. Machtinger): From an examination of the books and records of the corporation, did you discover any sales which were not reported on the corporate tax return for the fiscal year ended April 30, 1947?

A. Yes, sir, I did.

Q. Can you state to the Court what composed these contract [165] sales which were not reported by the corporation in its income tax return for the fiscal year ended April 30, 1947?

Mr. Campbell: Objected to as not the best evidence. These are matters which he states are not on the books and records. I would like to know the basis of it.

Mr. Machtinger: That is what he is going to say now as to what sales of the corporation were not reported on its income tax return.

Mr. Campbell: That were on its books and records?

The Court: If Mr. Campbell wants to, I will give him a chance to cross-examine before this witness testifies to it. The indications are that he found something that wasn't on the books. Now, that could mean a great many things, but it also has a possibility of some negative finding. He must have found it out some way, assuming he did find it out. He may have found physical contracts which weren't recorded. He may have gotten admissions or statements; a great deal may have happened. But we are in the dark yet as to how he discovered it, and

(Testimony of Donald E. Phillips.)

until there is some satisfactory basis for that, I don't see how we can allow his conclusions.

Mr. Machtinger: Strike the last question.

Q. (By Mr. Machtinger): Would you state how you discovered that the sales of the corporation did not correspond with the sales reported on the income tax return of the corporation? [166]

Mr. Campbell: That is assuming a fact not in evidence, that they did not correspond.

Mr. Machtinger: I didn't say whether they were in excess or not in excess. He reported that they were not—I mean he testified that they did not correspond.

The Court: Did you discover that there was a difference or not?

The Witness: Yes, sir, I did.

The Court: All right. How did you discover it?

The Witness: The first indication was submitted to me as informant information.

The Court: That is out. We don't want any hearsay from informants. We want to know what you did, what you know of your own knowledge about it.

The Witness: A list of 11 customers of this corporation was given to me, and I checked the records of these 11 customers and found amounts paid by these customers that were not reflected in the records of Gene Clark, Incorporated in either the books or in the income tax returns filed.

The Court: Are those customers here or going to be produced? You know the situation; you have studied it. Now, let's——

(Testimony of Donald E. Phillips.)

Mr. Machtinger: We had originally planned to produce those customers, but when petitioner conceded that there would be fraud, that he would waive the requirement of proof of fraud—— [167]

The Court: Then why are you trying to prove it?

Mr. Machtinger: I am merely trying to show the total additional corporate income—— [168]

\* \* \* \* \*

Q. Did you study and examine the adjustments made in the statutory notices of deficiency issued to the petitioners in this case?

A. Yes, I did. [169]

\* \* \* \* \*

Q. (By Mr. Machtinger): Mr. Phillips, you have examined the adjustments made [170] in the statutory notice. Have you prepared a report from which the adjustments in the statutory notice were derived? A. Yes, sir.

Q. Is that report the 30-day letter or the revenue agent's report in connection with the Gene Clark, Incorporated case? A. Yes, sir, it is.

Mr. Machtinger: At this time, Your Honor, I would like to offer in evidence the report prepared by this witness, which is the revenue agent's report on the incorporated case, which discloses the basis for the adjustments in the 90-Day Letter.

Mr. Campbell: To which we object at this time as no proper foundation laid.

No, I will withdraw the objection. I will, in the interests of time, withdraw the objection.



(Testimony of Donald E. Phillips.)

The Court: All right. The objection is withdrawn.

Mr. Campbell: May I see——

The Court: Put them in.

Mr. Campbell: As I understand it, the offer is not as to the truth of the items contained herein, but as to a report which he made which was the basis of the deficiency letter, is that correct?

Mr. Machtinger: That is correct.

I have offered this as the report which the internal revenue agent made, from which the adjustments—— [171]

The Court: It is admitted without objection, considering the statement of counsel, however, reserving the fact that it is not evidence of the truth of the facts, but merely as to the manner in which the calculation was made, and the basis for the calculation.

Mr. Campbell: My understanding, it is offered for that purpose, and I have no objection to it for that purpose.

The Court: I think we understand that.

The Clerk: Respondent's Exhibit A admitted in evidence.

(Respondent's Exhibit A was received in evidence.)

Mr. Machtinger: If your Honor please, we previously offered for identification what was marked Respondent's Exhibit G, and the item which had previously been offered was part of this report that

(Testimony of Donald E. Phillips.)

is now incorporated in this report, as shown to counsel.

The Court: Well, counsel can examine it as closely or otherwise as he cares to. I am not admitting these papers as a demonstration of any facts stated in the revenue agent's report, as to omitted income or anything of that sort. I am admitting it to show that he made his calculation on the basis of these items. [172]

\* \* \* \* \*

Q. (By Mr. Machtinger): With respect to the notice of deficiency issued to Mr. and Mrs. Koyl which disclosed additional income or set up additional income for the year 1946 for each petitioner of \$9,477.24: Referring you to Exhibit Q of Respondent's Exhibit G, line E, this discloses or sets up a distribution to Mr. Koyl of \$18,954.49 for the year 1946. Is that the adjustment which resulted in the adjustment in the notice of deficiency of \$9,477.24 for each of the petitioners Archie and Fawn Koyl?

A. Insofar as I know, yes.

Q. Is that figure one-half of the \$18,954.49 because of the community property basis of report in California?

A. Yes, and because they filed separate returns.

\* \* \* \* \* [174]

The Court: There has been nothing except to show how this witness made the calculation, in explanation of the corporate 90-Day Letter. There

(Testimony of Donald E. Phillips.)

is nothing to show that his calculation was correct or was based on fact, and the intimations have been right through this hearing that a settlement was reached on a different basis, at least as to the overall picture. Now, I don't know what this witness knows, although it is beginning to be rather increasingly clear, as far as his own personal knowledge is concerned, he doesn't know anything, and that the facts have not been produced.

Now, I haven't the slightest desire to influence counsel either way. You can press on this within reason as much as you want. It is a matter for you to judge, not me, but it is by no means necessarily to your detriment that these facts are not brought out. If petitioner doesn't want to know what the basis is and wants to face his burden of proof blindly, that is his problem. If you have in your mind in preparing this case circumstances that I don't know anything about, which is not only quite possible but very likely, I never knew [176] anything about this case until I read the pleadings and heard the opening statements—then you go ahead and try to get at it. But you might just as well keep in mind that unless counsel doesn't object, this witness is going to testify only as to facts, and he is not going to supply those facts from hearsay from other people or from preliminary activities on his part.

Q. (By Mr. Machtinger): Mr. Phillips, in the course of your examination of the books and records of the corporation, did you examine the cash

(Testimony of Donald E. Phillips.)

receipts records and the bank deposits of the corporation?        A. Yes, sir, I did.

Q. Did you analyze all the bank deposits of the corporation?        A. Yes, sir, I did.

The Court: Is that on the corporation's books or through some outside source?

The Witness: I previously answered the question, your Honor, that I examined the bank deposit slips at the various depositories, wherein the corporation maintained their accounts during these years.

The Court: Matters of that sort, bank statements, bank deposit slips, normally are stipulated or at least an effort is made to stipulate them. There usually isn't any doubt about them.

Mr. Campbell: I am not going to raise an objection. [177]

The Court: No stipulation has been here. If counsel doesn't object, go ahead.

Q. (By Mr. Machtinger): Did you reconcile the cash receipts records as against the bank deposits of the corporation?

A. I made a direct comparison between the cash receipts records of Gene Clark, Incorporated and the bank deposit slips at the various banks.

Q. Did you examine the cancelled checks of the corporation?        A. Yes, sir, I did.

Q. Did you reconcile those cancelled checks as against the sales records and the cash receipts records of the corporation?

Mr. Campbell: That is objected to. There is no

(Testimony of Donald E. Phillips.)

comparison, as I understand it, to be made from the corporation's checks and cash receipts.

The Court: Cash disbursements perhaps?

Mr. Machtinger: Against the cash disbursements of the corporation and as against the sales records.

The Witness: Will you repeat the question?

(Question read.)

A. I reconciled the cancelled checks or examined the cancelled checks of Gene Clark, Incorporated and compared them to their cash disbursements record. [178]

Q. (By Mr. Machtinger): Did you examine the cash receipts records and reconcile such records with the checks deposited in the bank deposits of the corporation?

A. Yes, sir, I did.

Q. Were the same checks as deposited in the corporation reflected on the cash receipts records?

Mr. Campbell: That is objected to as calling for his conclusion.

The Court: Well, I don't quite follow you on that.

Mr. Campbell: Well, "the same checks," I don't know, unless he examined the original checks which were deposited; I presume he could only examine the amounts of the checks deposited.

The Court: Well, he examined the bank deposit slips, and he determined there were certain deposits. Now, they either compared the cash receipts or they didn't. That is all I understand he is trying to get at.



(Testimony of Donald E. Phillips.)

Mr. Campbell: With that understanding, I have no objection.

The Court: All right. Did you compare them?

The Witness: The items in the bank deposit slips were compared to the items in the cash receipts records of Gene Clark, Incorporated, and they did not always correspond. [179]

Q. (By Mr. Machtinger): In what ways did they not correspond?

A. In that certain deposits had items listed that were not reflected in the cash receipts records.

Q. Did the amounts of the checks which were shown on the corporate books as having been received correspond with the deposit slips of the corporation in the bank accounts of the corporation?

Mr. Campbell: Just a moment. That is assuming that the books of the corporation showed the checks received.

The Court: Well, not necessarily. The witness has already testified that there were some checks in the bank deposits that weren't shown on the books. Now, how much they were and what the circumstances were and so forth, I don't know.

Mr. Campbell: All right, very well.

The Court: Do I understand the witness to say the bank deposits exceeded the cash receipts on the books?

The Witness: No, sir.

The Court: Well, were they less than the cash receipts on the books?

The Witness: They were the same, sir.

(Testimony of Donald E. Phillips.)

The Court: All right. Then let's finish that one mystery. Where did the differences occur?

The Witness: The differences occurred in that items listed in the cash receipts, that I personally looked at the checks in the hands of other people, were not deposited to the [180] bank account of Gene Clark, Incorporated.

The Court: But some other check was deposited?

The Witness: Someone else's check had been deposited in lieu thereof.

The Court: All right. I must say I drew out the answer. Do you object?

Mr. Campbell: Yes, your Honor, I ask the last be stricken.

The Court: About the examination of the books for the other companies?

Mr. Campbell: Yes.

The Court: If you do, I will strike it out.

Mr. Campbell: Yes.

Mr. Machtinger: Is the Court striking out that one part about examining the books of the other companies or this whole——

The Court: I am striking out only the part where he got his information from the books of other companies. He has said that the deposits and the cash receipts equalled each other in amount, that there were differences apparently in the way they were handled, and then he made certain statements as to how he checked those differences, and that part I have ruled out.

(Testimony of Donald E. Phillips.)

Q. (By Mr. Machtinger): Is the substance of your testimony in this respect [181] that the corporation substituted other checks for the ones that were set up on its cash—substituted in its deposits other proceeds than those received? Is the substance of your testimony, Mr. Phillips, that the corporation substituted other receipts for the checks received in payment of corporate sales?

Mr. Campbell: Objected to as assuming a fact not in evidence, and his evidence speaks for itself.

The Court: Well, I agree. If he knows any facts as to substitution of cash or checks or other funds, he can testify to them. If he doesn't he can't.

Mr. Machtinger: He has stated, if your Honor please, that he has examined all the bank deposit slips, that he has examined the checks which were listed as having been received, and that there were other items substituted in place of these.

The Court: The last part he has not testified to. I don't see how the two could equal unless some such thing had happened, but they wouldn't have to be checks. It could have been cash, and there is nothing to show that he knows how it was done, other than his investigation of other people, whose records could be brought here or could have been brought here. Now, if he knows that there was a check of, for illustration, \$1,000 received and recorded on the books, and that the corresponding bank deposit showed \$1,000 in cash, or if he has any way on the basis of his examination of the books

(Testimony of Donald E. Phillips.)

of the company itself to give any such facts, all right. If it is based on [182] investigation of records which are not in evidence and not available, then I am not going to permit him to go into it. Unless he has some specific information, I don't see that it makes any difference anyhow. I realize, or I assume that what you are trying to do is to show that in some manner the actual gross receipts were in excess of the gross receipts recorded on the books. Well, in some respects it has been admitted. But it hasn't been stated in specific amounts or specific items.

Now, this witness either knows them of his own knowledge or from examination of the books of the company or he doesn't.

Q. (By Mr. Machtinger): Mr. Phillips, did you examine the notice of deficiency as issued to Gene Clark, Incorporated? Have you examined the notice of deficiency? A. No, sir.

Q. Do you know whether or not your revenue agent's report relating to Gene Clark, Incorporated was used as a basis for the notice of deficiency issued to Gene Clark, Incorporated?

The Court: He testified once before that it was so used.

Mr. Machtinger: I thought I had limited that question.

Mr. Campbell: As to the individual, your Honor, not as to the corporation.

The Court: I understood—I may be wrong—that it was just the opposite. He testified to it

(Testimony of Donald E. Phillips.)

with respect to the [183] corporation and not the individuals.

Mr. Machtinger: I had thought it was the other way. But I gather, then, that it is to your knowledge that the revenue agent's report that you prepared was used as the basis for the notice of deficiency in both the corporation and the individual case?

Mr. Campbell: Just a minute. I object. He has testified he has never seen the notice of deficiency in the Gene Clark, Incorporated case.

The Court: That is right.

Mr. Campbell: I object to this question. It would be his conclusion, clearly, that it was used as the basis for anything in that report which he hasn't seen.

The Court: Well, it is here; you can still look at it. It still leaves the question of whether the testimony means anything.

Mr. Campbell: If counsel states it is, I will stipulate it is; I will stipulate that it is.

Mr. Machtinger: It is.

Mr. Campbell: All right, I will stipulate.

The Court: It is so stipulated then. Let's move on.

Q. (By Mr. Machtinger): With respect to fiscal year April 30, 1947, can you explain how you arrived at the adjustment in your revenue agent's report from which the notice of deficiency was issued to the [184] corporation?

A. Yes, sir. Upon examination of the contract



(Testimony of Donald E. Phillips.)

sales account, reported in the income tax return of Gene Clark, Incorporated of \$508,258.32, results of my examination disclosed an amount of \$83,960.08 that should have been added to the return.

Q. I am sorry. Should have been added to what?

A. The income reported in the tax return.

Q. Will you explain what facts you took into account in arriving at that figure?

A. Examination of the contract between Truman Johnson on the building of ten houses revealed that there was a contract price of \$330 per house.

Mr. Campbell: Just a minute. I am going to object. This is not responsive to the question. He was asked what he examined to determine it, not his findings.

The Court: Where was this contract, was it in the records of Gene Clark, Incorporated or not?

The Witness: It was in the records of Truman Johnson.

The Court: I will sustain it.

Q. (By Mr. Machtinger): The adjustment of approximately 83,000, to which you just testified, contained any amounts reflected from your examination of the bank deposits as substituted items?

A. Yes, sir, \$14,806.77.

Q. After you arrived at the total amount of additional [185] corporate income in your revenue agent's report, how did you arrive at the amount

(Testimony of Donald E. Phillips.)

that you set up as constructively received by the stockholders?

A. Based upon the stock ownership of Mr. Koyl and Mr. Clark.

Q. Did you reduce the amount of net income by any figure in order to arrive at the amount available for distribution? A. Yes, sir, I did.

Q. What did you take into account in reducing the net income of the corporation in arriving at the amount available for distribution?

A. Federal income taxes accrued upon the liability, additional liability set up from my report.

Q. Is that the figure set up in Schedule Q of Respondent's Exhibit G?

A. No, Exhibit Q was based upon, first, the adjustments to net income of \$102,050.17, \$273.97, other investments, \$36,149.29 of notes receivable, or a total of \$138,473.43, which I reduced by a total amount of \$63,488.47, which was composed of accounting adjustments as listed now, \$6,000, Truman Johnson, \$1,860.40, H. L. Brittain, \$49,210.15, reversal of deferred income method, \$2,714.42 of merchandise purchases disallowed, and \$3,703.50 of bad debts.

Q. After making that adjustment, did you then arrive at the total distribution per RAR? [186]

A. I did. That left a remaining balance of \$74,-984.96.

Mr. Machtinger: Would counsel stipulate that the witness would testify that he went through the same procedure in arriving at the total distribu-

(Testimony of Donald E. Phillips.)

tion per RAR for the years 1947, 1948, and 1949?

Mr. Campbell: I will stipulate that he would so testify. I do not stipulate as to the materiality of it.

Mr. Machtinger: If you would stipulate that he would so testify, then I believe there would be no need to take the witness through each of these computations on that schedule.

The Court: Well, maybe I don't quite understand the point. But there is no use stipulating as to what he would testify unless it is going to come into the evidence. Are you objecting to it coming into the evidence?

Mr. Campbell: No, your Honor, I will not.

The Court: All right. Then we will accept the stipulation.

Q. (By Mr. Machtinger): Mr. Phillips, from the total consideration per revenue agent's report, did you then arrive at the amount that was constructively received by each of the stockholders?

Mr. Campbell: Objected to as calling for his conclusion as to any amounts received by the stockholders.

Mr. Machtinger: I am merely asking him whether he so arrived rather than—— [187]

The Court: But you have got the words "constructively received" in there. I don't know what your basis is for constructive receipt of anything yet.

Mr. Machtinger: I will withdraw that question and rephrase it.

(Testimony of Donald E. Phillips.)

Q. (By Mr. Machtinger): Referring to line E of Schedule Q, entitled "Total Distribution per RAR," what did you then do in computing the amounts that were reflected in the notice of deficiency of each of the stockholders to arrive at the amounts reflected in the notice of deficiency for each of the stockholders?

Mr. Campbell: I will stipulate that he calculated at 70-30 per cent.

Mr. Machtinger: For the years in which there was a 70-30 stock ownership, is that right?

Mr. Campbell: I am referring to that first year, fiscal year 1947.

Mr. Machtinger: All right.

Q. (By Mr. Machtinger): For years subsequent to fiscal year 1947, Mr. Phillips, did you then make a comparable distribution on the basis of percentage of stock ownership? A. Yes, sir, I did.

Q. Is it from the resulting figures of amounts distributed per your revenue agent's report that the notices of [188] of deficiency were prepared, is that correct?

A. Insofar as I know, they were. [189]

\* \* \* \* \*

Cross Examination \* \* \* \* \*

Q. (By Mr. Campbell): Now, let us take, for a moment, the question of these items which you have referred to or counsel has referred to as substituted items, and you have there, have you not, a schedule with respect to the fiscal year 1947?

A. Exhibit A.

(Testimony of Donald E. Phillips.)

Q. How many pages do you have of that? [190]

A. Ten.

Q. Ten pages. Are those all with relation to the fiscal year 1947? A. Yes, sir.

Q. Or is that for all years? 1947?

A. 1947.

Q. Now, isn't it a fact, Mr. Phillips, that deposits were made in the corporation accounts of amounts totalling the exact amounts of the items which you have set forth in that exhibit?

A. In the corporation bank accounts? Yes, sir. These items were deposited in the corporation bank accounts.

Q. And those items which you have set forth in that exhibit and which you have also set forth in the body of your report and carried over into the deficiency letters, were in fact reported on the corporation return, were they not?

A. Not as income, if you consider that your income comes from the cash or the contract sales account.

Q. No, sir, that isn't what I asked you. I asked you if it isn't a fact that these specific items that you have set forth in your report as unreported were in fact reported on the corporation return?

Mr. Machtinger: Would counsel identify which column of specific items to which he is referring in Exhibit A that he has directed the witness' attention to? [191]

Mr. Campbell: I am referring to the column



(Testimony of Donald E. Phillips.)

of amounts which is headed here, "Unreported Item of Income."

Q. (By Mr. Campbell): Now, those specific items were in fact reported on the corporation return, were they not?

A. I couldn't answer that question as yet, Mr. Campbell, for the reason that in my opinion it is the sales record that is the record that says what is reported.

Q. Well, let's go back just a minute, Mr. Phillips. It is a fact, is it not, that all of these items set forth on this report were deposited in the corporation's bank account, is that right?

A. Yes, sir.

Q. And it is a fact, is it not, that the amounts deposited in the bank were reported in the gross sales of the corporation, is that not true?

I will reframe the question.

It is a fact, is it not, that all of the items which were deposited in the bank account of the corporation were reflected in the corporation tax returns?

Mr. Machtinger: I object to that question. The word "reflected" is something that I don't think the witness can properly answer.

The Court: It is a little bit vague, Mr. Campbell. What you were asking him before, as I understood it, whether all of the amounts deposited in the bank were included in gross [192] receipts on the return.

Mr. Campbell: Well, I amended it because some deposits in the bank would be in a different cate-

(Testimony of Donald E. Phillips.)

gory. But I will come back to these deposits.

Q. (By Mr. Campbell): Were not the deposits of the sums set forth in this schedule in the bank accounts reported in the sales of the corporation?

Mr. Machtinger: If your Honor please, I object to that unless the counsel specifically states whether he is referring to both the deposits under the heading "Unreported Item of Income" and the deposits entitled "Amount of Deposit" in the column 2.

Mr. Campbell: I think my question is clear to the witness.

The Court: I would think so. Let's at least find out. It may be necessary to go a little bit further.

The Witness: May I answer this to a specific, particular item?

Mr. Campbell: No, sir. I wish you would answer my question as a whole if you can.

Mr. Machtinger: If it is necessary for the witness to illustrate the answer, can he be so permitted?

The Court: You will have him on redirect. You can let him give all the explanations that are material to Mr. [193] Campbell's questions. But I think this witness knows what is in the return and knows what he put down as unreported items, and he knows whether they were in there and probably what slots they were in, if they were, and he knows as to the extent, if any, to which they weren't in there. I think he can explain it.

A. The amounts there are the amount deposited

(Testimony of Donald E. Phillips.)

to the bank accounts of the corporation. But in my opinion they were not reported as income to the corporation.

Q. (By Mr. Campbell): I am not asking you for your opinion. I am asking you if these specific amounts which went into the bank account were in turn reported on the income tax return?

A. No, sir, they weren't.

Q. Will you indicate to me on these 10 pages how many of these items—and enumerate them—that were deposited in the bank accounts were not reported on the return?

A. Insofar as I know, all of the items therein listed were not properly identified in the sales records, and that allowances were made in every instance where there was no identification.

Q. Now, Mr. Phillips, let's see if we can get together on the question and answer.

As I understood your testimony, every one of these items which you have picked up here, you picked up from the corporation's records, is that correct? [194]

A. That's correct, sir.

Q. And every single one of these items went into the bank account of the corporation, is that correct?

A. That's correct, sir.

Q. And is it not true that the bank account of the corporation was fully reflected in the return filed by the corporation?

Mr. Machtinger: I again would have to object to the word "reflected." It could be reflected by being admitted from the corporation——

(Testimony of Donald E. Phillips.)

Q. (By Mr. Campbell): Presented in the return? A. Yes, sir.

Q. All right. Now, we have got a further basis to deal on. Now, as I understand your testimony, though, you say that there were some items that you found in the sales receipts on a particular day which do not correspond with a particular check which was deposited, is that right?

A. That's right, sir.

Q. Now, isn't it a fact, did you not discover during the course of your examination that the corporation cashed many accommodation checks for customers?

A. I didn't discover this in my examination, no, sir.

Q. I asked you if you did not discover the fact, if you were not advised of the fact that the corporation cashed many [195] accommodation checks for their customers?

A. I was advised that that was true.

Q. All right. And were you not advised by the various employees whom you interviewed that checks were regularly cashed for the cleaning establishment, for the convenience of the cleaning establishment, which was located next door to the plumbing shop in El Monte?

Mr. Machtinger: I object to that question, your Honor. It goes into facts which are very vague and general as to whether or not he was advised as to many checks, and by the cleaning establish-

(Testimony of Donald E. Phillips.)

ment. These are things which petitioner can bring out himself.

The Court: He has brought up a lot of unreported items. All he is being asked is whether he was advised about cashing checks. That doesn't mean he accepted the advice as true. You wanted to bring out how he made these calculations, and that is all we are getting at. There has been no evidence in the case of any such cashing of checks, and I don't know where at the moment it is going to. But the fact that he was advised that they had cashed one or 10,000 checks doesn't mean that they did it.

Q. (By Mr. Campbell): Were you so advised?

A. Yes, sir, I was so advised.

Q. And did you make any investigation to determine the [196] truth of the advice which you received in that connection?

A. No further investigation than a request to the same people to furnish me some information to that effect.

Q. Did you interview the cleaning establishment which it was told you that checks were cashed for?

A. No, sir, I did not.

Q. You simply asked for further proof, as I take it, and I take it further that no such proof was forthcoming while you were there, is that right?

A. That's right.

Q. Now, with respect to these various checks which you have listed here as being unreported



(Testimony of Donald E. Phillips.)

income—and you listed them as unreported income from cash sales, did you not?

A. I believe from substituted items.

Q. All right.

A. You have my copy of the report.

Q. Now, isn't it a fact——

Mr. Machtinger: I am not sure the witness finished his answer.

The Court: I think, Mr. Campbell, that you have——

The Witness: I think you have misappropriated——

Mr. Campbell: Pardon me. I didn't mean to carry it away.

The Witness: My heading of the exhibit is "Unreported Income Determined from Substituted Items in Bank Deposits." [197]

Q. (By Mr. Campbell): And as I take it, the basis of your heading and of your placing these matters in this report in this manner was from the fact that you did not find sales tickets where these particular checks were listed, is that right?

A. That's right, sir.

Q. And as I gather, what you are trying to say is, and the effect of your testimony—correct me if I am wrong—is that these items were reported, but that in your opinion similar items were not reported, is that right?

A. No, sir. It is my contention that the fact that they go into the bank does not mean that they are the reported sales. The reported sales are

(Testimony of Donald E. Phillips.)

those that are listed in the sales register, sales journal, or whatever accounting document the company might have.

Q. You reconciled the reported sales to the bank account, did you not; is that correct?

A. Yes, sir.

Q. And you found that they were in harmony, did you not?

A. In total amounts, that is correct, sir.

Q. So that any statement of unreported sales, and as to these items, was simply a conclusion which you drew, is that right?

A. Possibly it is only a conclusion, sir, but the cash receipts did not match the items in the bank deposit. [198]

Q. When you say they did not match the items in the bank deposit, you mean by that that you did not find an individual receipt in the exact amount of these particular checks, is that right?

A. That's right, sir.

Q. And did you make any investigation to determine whether or not some of these checks had been received in situations where a customer would receive some change back from his check?

A. I made whatever investigation was possible, sir.

Q. I didn't ask you that, sir. I asked you if you made any investigation. Maybe you concluded that none was possible. But did you make any investigation of that?

(Testimony of Donald E. Phillips.)

A. I made a detailed itemized list of all of the sales reported by the corporation, sir.

Q. Did you make any investigation to determine, for example, if a customer would come in and buy \$25 worth of merchandise and either write and cash a \$35 check or turn in a pay roll check for that amount, and receive the balance in cash?

A. No, sir, I did not.

Q. And, as a matter of fact, some of these items which you have listed here are such things as postal notes and money orders and travelers' checks, are they not?      A. Yes, sir.

Q. And it would be an odd coincidence if the amount of a cash purchase of plumbing supply equalled the exact amount, for [199] example, of a travelers' check, isn't that correct?

A. That's correct, sir.

Q. Now, as to these ten sheets which comprise Exhibit A, and all of which refer to the year 1947, with the exception of travelers' checks and postal money orders, you had the clearing number of each check, did you not?      A. Yes, sir, I did.

Q. And did you ascertain the maker of these checks and for what purpose these checks were made?      A. No, sir, I did not.

Q. Did you at the time make any attempt to ascertain if, simultaneously with these items, there was withdrawn from inventory, merchandise?

A. No, sir, I did not.

Q. And would your testimony be the same as

(Testimony of Donald E. Phillips.)

to each of the years here involved with respect to this type of item?

A. No, sir, it would not.

Q. In what respect would it vary as to any year?

A. In Exhibit E there are several identified items as to the third party.

Q. What page is that of your report?

A. Page 59 is where the schedule—60.

Q. To what year does that refer?

A. That is to the year ended April 30, 1948.

Q. All right, sir. And how many pages of items are [200] there with respect to that year?

A. Five pages, sir.

Q. Out of those five pages of items, you say that some of them were identified?

A. Yes, sir, they were.

Q. You say five items?

A. Five pages, I said.

Q. How many items? A. 19 items.

Q. Now, with respect to those 19 items, were those items reported in the corporation return?

Mr. Machtinger: If your Honor please, counsel could be more specific in that question as to whether or not he is asking the witness whether those items were included in the corporate income as reported on the return. Is that the substance of your question?

Mr. Campbell: Yes, yes. That is the purport of my question.

A. No, sir, they were not.

(Testimony of Donald E. Phillips.)

Q. (By Mr. Campbell): Were similar items reported on the return? A. Yes, sir.

Q. What were the similar items?

A. In regard to the deposit of December 10, 1947, total amount of \$16,851.59, included therein was a Rucklos & Company [201] check in the amount of \$6,550.

Q. That is one of the items which you have on this schedule? A. Yes, sir.

Q. And the amount of \$16,851.59 was carried into the gross sales of the corporation for that year?

A. Yes. And included in the schedule of sale of assets was an amount of \$6,550 less \$1,435.41.

Q. So that that amount was placed in the bank?

A. The total amount of \$6,550 was, yes, sir.

Q. And what was the total amount of the Rucklos check? A. \$6,550.

Q. And that was reported on the return?

A. No, sir.

Q. Well, now, weren't all those bank deposits—the bank deposit of \$16,851.59, which included this Rucklos check—reported on the return?

A. There is no line on an income tax return for the total of the bank deposits to be reported, Mr. Campbell.

Q. I understand, but weren't the bank deposits carried directly—those relating to sales—carried in the company's books under the heading of sales, and reported in the return?



(Testimony of Donald E. Phillips.)

A. As I said, sir, that particular sale is reported in the schedule of a sale of assets.

Q. I see, and was reported on the return? [202]

A. In an amount less than \$6,550. It was reported in an amount of 5,000.

Q. Was the balance reported in sales?

A. No.

Q. If you know? A. No, sir, it was not.

Q. And is that the only item to which you can call attention in that five pages? Before you go from that item, did you determine who, if anyone, got the proceeds of that, specifically?

A. No, sir, because that amount did go into the bank account of Gene Clark, Incorporated. But I could give you the detail of the cash receipt for which there was no deposit made.

Q. Did any of the stockholders withdraw that amount from the bank? A. Not as such, sir.

Q. All right. What other item have you got out of these five pages?

A. Included in June 20, 1947, a total deposit of \$11,813.24, the Hamilton Homes, Incorporated check number 1385 in the amount of \$2,445 was deposited.

Q. Was it reported in sales?

A. No, sir, it was not.

Q. Well, was that a substituted item, then?

A. Yes, sir, it was. [203]

Q. What was it substituted for?

A. In part, for a Charles Hasekian check of \$1,900.

(Testimony of Donald E. Phillips.)

Q. And what else?

A. And in part for cash receipts 4622, 4625, 4626, and 4627 of Gene Clark, Incorporated. Do you want the details on the names?

Q. Were these other receipts carried in the gross sales of the corporation?

A. Yes, sir, they were. And I did not add them to income.

Q. All right. Now, how many other items have you got in fiscal '48?

A. Hamilton Homes, Incorporated check number 1436, included in the deposit of July 30, 1947 in the total amount of \$10,016.46; that check in the amount of \$2,170.

Q. And that was not reported in sales?

A. No, sir, it was not.

Q. All right. Now, let me ask you this with regard to the fiscal year ending April 30, 1948. You testified, I believe, that the basis of your computation was simply on the basis of stock ownership. Did you make any determination in that regard as to when, if at all, Mr. Koyl ceased to be active in the corporation?

A. Yes, sir, I did, in that I treated the dividends as liquidating dividends upon the sale of his stock.

Q. Now, it is a fact, is it not, that the actual transfer [204] of his stock came sometime before the end of the fiscal year, isn't that right?

A. Yes, sir.

Q. But you continued to treat items on your constructive dividend basis as being divided to

(Testimony of Donald E. Phillips.)

Koyl right up to the end of the fiscal year, didn't you?      A. Yes, sir.

Q. So that, actually, some of these transactions which you have related to Koyl in your workup of this matter occurred at a time when he was not a stock owner, is that right?      A. Yes, sir.

Q. Now, in that connection, and with regard to these so-called constructive dividends for these two years or for the subsequent two years, did you make any effort to ascertain if, in fact, any of the sums which you have set up as constructive dividends were actually physically received by any of the stockholders?

A. Yes, sir, we traced them into their bank accounts.

Q. Let us go back to Exhibit A. What, if any, of those sums did you trace into Mr. Koyl's bank account? I understood you to say they went to the corporation bank account.

A. Those sums did, sir.

Q. And did any of those sums in Schedule A go into Mr. Koyl's bank account?      A. No, sir.

Q. Did any of these sums set forth in these schedules, now, with respect to the so-called substituted items, referring now to specific items that you have set out in these schedules, go into Mr. Koyl's bank account?

A. None of the things from the substituted item schedules could have gone in any other bank account than the corporation bank account.

(Testimony of Donald E. Phillips.)

Q. Did any of them go into Mr. Clark's bank account?      A. No, sir.

Q. They all went into the corporation bank account, didn't they?      A. Yes, sir.

Q. And they were all treated as corporation funds at all times, weren't they?

A. Yes, sir.

Q. So that, so far as all of these items themselves are concerned, these are not as you—set forth in your report, unreported items of income; isn't that right?

A. They are, as I stated, sir, in my report, they are substituted items.

Q. These were items of reported income, isn't that right?

A. They are not listed in the sales records.

Q. Isn't it a fact that the corporation tax returns show a reconciliation with the books? Are you familiar with that?

A. Yes, sir, they do reconcile to the books. [206]

Q. And included in that reconciliation with the books is reconciliation with the corporation bank account, isn't that right?      A. Yes, sir.

Q. Included in that corporation bank account are these various items, isn't that right?

A. Yes, sir.

Q. All right. Now, as I understand you, in computing what you determined to be the amount of constructive dividends specified by the stockholders, you took into account accrued Federal income tax, is that right?      A. Yes, sir.

(Testimony of Donald E. Phillips.)

Q. Did you take into account accrued State income taxes? A. No, sir.

Q. Did you take into account accrued State sales taxes? A. No, sir.

Q. With respect to the fiscal year ending April 30, 1949, how did you treat the division of these so-called unreported or substituted items?

A. For the year ending April 30, 1949?

Q. Yes.

A. The total amount of dividends available of \$27,437.93 were distributed.

Q. How did you divide it among the stockholders?

A. \$26,233.75 to Gene Clark; \$1,204.18 to Archie Koyl. [207]

Q. And was that on the basis of the change in stock ownership in January of 1949?

A. Yes, sir, it was.

Q. You took it into consideration, then, that at the time that Clark sold out to Koyl before the end of the fiscal year, although you had not taken it into consideration at the time that Koyl sold out to Clark before the end of the fiscal year; is that right?

A. Actually, it was taken into consideration in the other one, in that the dividends declared after Mr. Koyl was out of the corporation by Mr. Clark were taken away from the amount allowed against earned surplus in the previous year—

Q. You charged him with dividends after he left there, didn't you?



(Testimony of Donald E. Phillips.)

A. They were constructively received in the prior year.

Q. You say—well, let's go on with this matter of constructively received. Now, you must have worked out somewhere how much cash or property Mr. Koyl or Mrs. Koyl received. You have any schedule on that? A. No, sir, I do not.

Q. Did you make up such a schedule as to what they actually received?

A. We made an attempt at that, yes, sir.

Q. Well, do you have those papers with you here?

A. I do not at this moment, sir. [208]

Q. Can you produce those papers?

Mr. Machtinger: If your Honor please, the use of "constructively received" has been from the corporation and not from other sources. If counsel is asking the witness as to the constructive receipts of unreported income of the corporation, the witness has before him his working papers, and that has been the content of his testimony up until now.

Do I understand that you are departing then from the corporate, constructive receipt of corporate income?

Mr. Campbell: I am trying to find out—he allocated these as constructive dividends to the petitioners in this case—I am trying to find out, aside from constructively, what they actually received. This man made the investigation.

Mr. Machtinger: Are we off now from the receipt of the corporate income? That is the point.

(Testimony of Donald E. Phillips.)

Mr. Campbell: By this question, yes.

Mr. Machtinger: We don't have in issue right now, do we, whether or not the petitioners had assessed against them or had deficiencies asserted against them because of their receipt of items other than from the corporation?

Mr. Campbell: I am trying to see what they received, other than from the corporation or anywhere else that this agent found.

Mr. Machtinger: I don't see where you have made the question relevant to the issue that we have before us now. [209]

Mr. Campbell: If the Court please, I understand the issue before the Court is what Archie and Fawn Koyl received. The allegation and the proof offered here and as set forth by the Commissioner in his letters is that they received certain dividends from the corporation, as well as other sums, as set forth in the 90-Day Letter. Now, I am trying to ascertain how these dividends were paid.

The Court: Are you talking about regular or constructive dividends?

Mr. Campbell: I will ask a question as to that.

Q. (By Mr. Campbell): Were any regular dividends declared?

A. Only one, in the amount of \$20,000.

Q. And that was at a time when Gene Clark was a sole owner of the corporation?

A. Except for one qualifying share.

Q. Except for one qualifying share, and that

(Testimony of Donald E. Phillips.)

was not at a time that Mr. Koyl was connected with the corporation?      A. That's right.

Q. And that \$20,000 was paid to Mr. Clark, was it not, or for his benefit?      A. \$19,996.17.

Q. At any time that Mr. Koyl was connected with the corporation, was there a regular dividend declared?      A. No, sir. [210]

Q. And all of the other items that you have set forth as dividends received by him from the corporation are what you have referred to as constructive dividends, aren't they?      A. Yes, sir.

Q. Did he actually receive those in cash or property?

Mr. Machtinger: I object to that question. The witness has testified as to the basis on which he prepared his report, setting forth the amount of additional dividends to the stockholders on the basis——

The Court: He hasn't said yet what he means by constructive dividends. I think it is about time he was saying so.

Q. (By Mr. Campbell): What do you mean by "constructive dividend"?

A. Moneys available to the stockholders of the corporation that they have taken for their own uses.

Q. So that you include in the words "constructive dividend" money which they have taken, is that correct?      A. Yes, sir.

Q. And that exclusively, money which they have taken, is that right?

A. Money and property.

Q. Which they have taken?      A. Yes, sir.

(Testimony of Donald E. Phillips.)

Q. Now, I want to know what money and property Mr. Koyle took, based on your examination of these corporate records. I [211] would like to know the specific sums and the times, specific assets. Can you give me that?

A. I couldn't give it to you at this time, sir. I'd have to go through my work papers.

Q. Do you have anything in connection with that?

A. I have detailed analysis of his bank accounts.

Q. Yes.

A. And the names of the various items and things in their bank accounts.

Q. You have been here in court through this proceeding, have you not? A. Yes, sir.

Q. Have you examined the schedules which have been placed in evidence here as Petitioners' Exhibits 9, 10, 11, and 12? Have you examined those?

A. I have read those schedules.

Q. All right. Can you tell me anything, purport to set out certain moneys or assets of the corporation which Mr. Koyle received, in addition to those set forth in his returns? Now, I want to know if you can point out to me any other money which he received from the corporation by way of what you call a constructive dividend?

A. As an accountant, I have not had an opportunity to see if those schedules are correct, sir.

Q. Well, let's forget the schedules. What schedules have [212] you got on it?

Let me ask you this: I will withdraw the last

(Testimony of Donald E. Phillips.)

question. Your 30 percent is simply a formula, isn't it?

A. Yes, sir, it is.

Q. And it is not based on any actual receipt of money by Mr. Koyl, is it?

A. No, sir. By the nature of this case, I was unable to determine actual amounts.

The Court: It is 30 percent of what?

Mr. Campbell: I didn't get your Honor's question.

The Court: I say, it is 30 percent of what?

The Witness: The stock ownership.

The Court: I know that. But I mean, you have been talking about constructive dividends. You apparently mean actual dividends, though undeclared dividends, and apparently there is some cash represented and some property represented, and you attributed 30 percent to Mr. Koyl and 70 percent to Mr. Clark?

The Witness: Yes, sir.

The Court: Now, 30 percent of what and 70 percent of what? What money are you talking about? What property are you talking about?

The Witness: My Schedule Q, your Honor; I took the adjustments to net income in each of the years to the corporation, reduced by accounting adjustments that were not available, [213] and had total distribution figure, and then the year ended April 30, 1947, it was \$74,984.96.

The Court: Aside from the question of the amounts for the moment, does the cash part that you have allocated represent what you correctly or



(Testimony of Donald E. Phillips.)

not are characterizing as unreported income, or isn't it? Unreported corporate income?

The Witness: It is unreported corporate income.

The Court: You said some part of it was property. You certainly should be able to tell us specifically what that is.

The Witness: In the first year it consisted of the Kansas farms.

The Court: All right. What other property?

The Witness: In the second year, this report contained some assets distributed.

The Court: What do you mean by assets distributed?

The Witness: It consisted of some assets that were supposedly sold, according to the records, to some third party, but in fact the assets were distributed in kind to the officers, the stockholders.

The Court: What type of assets were they?

The Witness: They were trucks and automobiles, your Honor.

The Court: By that you mean that the title was transferred to the officers? [214]

The Witness: Stockholders, yes.

The Court: Is there anything else except the farms and the assets that you are talking about that was distributed in kind?

The Witness: Only the distribution of the personal residence to Gene Clark, the Truman Johnson \$6,000 outside of escrow amount.

The Court: You include in this constructive dividend setup the forty-odd hundred dollars that Mr.

(Testimony of Donald E. Phillips.)

Koyl said was—represented work done on his house by somebody who owed the corporation some money, where that debt was cancelled?

The Witness: Not as a specific item, your Honor.

The Court: I see. Well, except for properties which you have mentioned and everything else that you referred to as a constructive dividend, the explanation in your mind is that it was unreported corporate income which, not having gotten into the corporate coffers, went to the stockholders on a 70-30 basis, is that correct?

The Witness: Yes.

The Court: All right.

Have you just a few questions?

Mr. Campbell: No, I have several questions, your Honor.

The Court: Well, we have a few minutes. Maybe we can ask one of them, anyhow. [215]

Q. (By Mr. Campbell): You referred to some cars and trucks transferred to officers or stockholders in the second year. Was that in the fiscal year 1948, ending April 30, 1948?

A. Yes, sir, it was.

Q. To whom were those cars and trucks transferred?

A. I better say I can't remember, sir, because I can't.

Q. Weren't they paid for?

A. In the records of the corporation, they were paid for at book value, I believe, depreciated book value.

(Testimony of Donald E. Phillips.)

Q. But you don't recall what officer or stockholder received those, is that right?

A. I don't want to answer your question incorrectly, and I can't remember at this time.

Q. Do you have anything you can refer to to refresh your recollection? A. Yes.

Q. Will you do so?

Now, you referred to distribution of property, of Kansas farms. It is a fact, is it not, and your investigation disclosed, that they were carried as an asset on the books of the corporation; is that right?

A. Yes, sir, they were.

The Court: Under what heading were they carried as assets of the corporation? [216]

The Witness: Notes receivable, I believe, from the officers.

Q. (By Mr. Campbell): The notes receivable represented the corporation's investment, the amount of money that was taken out of the corporation in that regard? A. Yes, sir.

The Court: Well, I'd like to get that clear. As I understand it, then, the properties were not carried on the books of the corporation, but notes receivable growing out of the transactions with respect to the properties were carried on the books; is that correct?

The Witness: Yes, sir. [217]

\* \* \* \* \*

Q. (By Mr. Campbell): Just before the recess yesterday afternoon, you stated that you had worked up some kind of a schedule showing the

(Testimony of Donald E. Phillips.)

cash or other assets received by Mr. Koyl. Do you have such schedule? A. No, sir, I do not.

Q. Do I take it that you did not work up such a schedule?

A. Not a particular schedule. I only had the bank deposit items to his various bank accounts.

Q. All right. We will come to those in just a moment. Incidentally, were the bank deposit items you are referring to, the items in your report whereby you added to corporation income all deposits to the accounts of Archie and Fawn Koyl; isn't that correct?

A. I did not add all deposits.

Q. With certain exceptions?

A. With certain exceptions, yes, sir.

Q. All right. Now, let's go back a moment or two on this matter of what you have referred to as substituted items, and I believe we were examining the year 1948 in your schedule, which [221] consisted of some five pages of items, four or five of which you said you had identified, is that correct?

A. I believe it was 19, sir.

Q. 19, all right. Well, let's take an example of your items which you have identified. For example, let's turn to the schedule and to page 63 of your report, and one of the items which you have identified is that of Pacific Pumps, Incorporated; is that correct? A. Yes, sir.

Q. And as you have it listed here, you say, "Unreported Item of Income, \$1,094.52." Do you observe that item? A. Yes, sir.

(Testimony of Donald E. Phillips.)

Q. Now, it is a fact, is it not, that that \$1,094.52 was set forth in the corporation books, isn't that true? A. Only in the bank deposits, sir.

Q. Well, let's see if we can trace this item through. Referring now to the cash received record of the corporation, page 73, and to the next to last item on that page where there is listed the item "E. J. Weiss, \$1,094.52," that is the same item, is it not? A. Yes, sir, it is.

Q. E. J. Weiss was president of Pacific Pumps, is that correct? A. I don't know that, sir.

Q. All right. But that is the same item that you have [222] referred to in your accounting as being an unreported item of income? A. Yes, sir.

Q. And that is listed there as a credit to accounts receivable and a charge to net amount received and deposited, is that correct?

A. Yes, sir.

Q. And that was carried into the bank account, was it not? A. Yes, sir.

Q. Will you refer to the sales journal in that same book and to page 68 thereof?

Mr. Bryant: For the record, what was the last page the witness was referring to?

Mr. Campbell: Page 73.

Q. (By Mr. Campbell, continuing): Page 68 of the sales record, and I will ask you if you do not find that the same item is listed thereon?

A. I do, sir.

Q. And will you point the item out to me? It is about the tenth item down, is it not?



(Testimony of Donald E. Phillips.)

A. Yes, sir, it is.

Q. And it is there debited to accounts receivable and credited to sales plumbing, is it not?

A. Yes, sir, it is. [223]

Q. And is a part of the total of sales for January 1948 of \$40,913.50, as shown at the bottom of that page; is that correct? A. Yes, sir.

Q. That is the figure which was carried as a part of the item of sales, as set forth in the corporation's income tax return for that period, is it not?

A. Yes, sir, it is.

Q. So that, as to that item, that specific item which you have identified was reported in the income tax return of the corporation, was it not?

A. Yes, sir, it was. But it was incorrectly labeled as being received from Mr. Weiss, because it was not.

Q. From whom was it received?

A. Pacific Pumps.

Q. Mr. Weiss is president of the Pacific Pumps, is he not? A. I do not know that, sir.

Q. Well, that is the same item of \$1,094.52 which you say is unreported, is it not?

A. I did, sir, in my report.

Q. All right. Now, with regard to the year 1950, fiscal year, how many pages in your report of these so-called substituted and unreported items of income are there? That is, I believe, pages 77 to——

A. Two pages.

Q. And what are the pages in your report?

A. 77 and 78.

(Testimony of Donald E. Phillips.)

Q. And how many of those items did you identify? A. One, sir.

Q. It is a fact, is it not, that in that year and as in prior years, all of these items were deposited in the corporation's bank account?

A. Yes, sir.

Q. And the total receipts of the bank account correspond with the sales as recorded in the company's books?

A. They coincide with the cash receipts.

Q. Coincide or correspond, whichever word you want to use; and were reported in the corporation's tax return, is that correct?

A. Not as these specific sales.

Q. In a similar amount?

A. In a similar amount, yes, sir.

Q. Those sales are specified in—the particular sales are specified in the return, are they?

A. No, sir, they are not.

Q. Now, do you have a list or a schedule of the items for which you state these were substituted?

A. Yes, sir, I do.

Q. Will you produce that? [225]

A. For the year 1950, sir?

Q. Do you have it for all four years?

A. Yes, sir, I do.

Q. Is that a part of your report?

A. No, sir, it is not.

Q. And it was not used, as I take it, then, in setting forth the matters that were set forth in the assessment letter here?

(Testimony of Donald E. Phillips.)

A. It was used as my work papers, from which this report was prepared.

Q. Do you have those schedules before you?

A. Yes. This is 1948.

Mr. Machtinger: May I see the schedules?

Will counsel ask the witness to identify specifically the schedules to which we are now referring?

Mr. Campbell: Yes, I will mark them in just a minute, Mr. Machtinger.

Q. (By Mr. Campbell): You have produced here some four schedules consisting of a large number of work sheets. Are these the sheets which you state contain the items of sales which were not reported in the returns? A. Yes, sir.

Q. And these are not the same items which you have listed in your revenue agent's report as being the unreported items, is [226] that correct?

A. In the legend in these on the right side, with the "U," the ones with the "U."

Mr. Machtinger: Will you speak louder?

The Witness: The ones with the "U" after them are the ones that are included in my report.

Q. (By Mr. Campbell): Well, in order that I may understand this, will you state what you have recorded here?

A. I first made a transcript of all of the bank deposit slips in the records of the various banks, and from that transcript and the cash receipt records of Gene Clark, Incorporated, I endeavored to match corresponding entries. After those items had been matched, the unidentified items of cash re-

(Testimony of Donald E. Phillips.)

ceipts and the unidentified items on the bank deposit slips were then put onto this schedule. Then further matching was done within this schedule, and all items of currency or checks issued by Gene Clark, Incorporated were assumed to be currency and unidentifiable.

Q. Well, then, if I understand you correctly, your process was to match the bank deposits, the specific items of bank deposits against specific sales records, and where, for example, a check had been deposited in, we will say, the amount of \$69.03, and you found no sale in that precise amount, you took that as an unreported sale; is that correct? [227]

A. Yes, sir.

Q. Without further investigation?

A. Yes, sir.

Q. Now, isn't it true that in that investigation that you found a large number of sales for which you found no corresponding cash?

A. Yes, sir, that is true.

Q. How did you treat those transactions?

A. On any sale that was not identified by amount, or was summarized, I used the amount of that sale or cash receipt as a reduction from the schedule in which I had added these unreported or so-called unreported items.

Q. Well, let's assume, for example, that on a given day there were receipts for \$500 in sales. There were \$500 worth of checks deposited in the bank, but the constituent checks were in amounts which did not correspond with the exact sales. How

(Testimony of Donald E. Phillips.)

did you treat those items? Did you treat them both as unreported sales, both groups?

A. No, sir, I would not. I would have used the unidentified items in the bank deposits as an addition to my schedule, but the unidentified sales would have been used as a reduction of the same schedule.

Q. You would take the identified sales, as set forth on the receipt book, is that correct, and would you then credit those against the sales reported?

A. I don't understand the question.

Q. All right. For example—and this occurred very often, did it not—you would find \$500 worth of sales, and you would also find a \$500 deposit, but the items making up the deposit were largely in checks and in amounts which did not correspond to the receipts, is that correct, to the individual receipts?

A. Yes, that's correct.

Q. Now, how would you treat those two groups of items, that is, the checks as compared to the receipted sales?

A. If there was detail of the sales, listing specific amounts, and there was no corresponding bank deposit item to any one of the individual sales, I would then add the bank deposit item to income.

Q. And what would you do with the sale for which you found no corresponding bank deposit, specific sale?

A. I would do nothing.

Q. Well, how were those sales treated then in your report?

A. They were unchanged.



(Testimony of Donald E. Phillips.)

Q. Well, now, you took those as the reported sales of the corporation, is that correct?

A. Yes, sir, whenever there were detailed amounts of the sales, they were allowed.

Q. Isn't it a fact that from the sales records, now, exclusive of the bank deposits, the record of sales of the corporation equalled the amount of sales reported; is that [229] correct?

A. Yes, sir.

Q. And you say also the bank deposits equalled the amount of sales reported on the return?

A. Yes, sir.

Q. But that you added to sales all of the bank deposits, however, which did not correspond in exact amount with an individual sale on the particular day; is that correct? A. Yes, sir.

Q. And on the basis of that, you increased the amounts of the corporation income in those amounts as set forth in your report, which is here in evidence? A. Yes, sir.

Q. And on the basis of that, you distributed, after making some allowance for accrued Federal income taxes, the balance in your report to the individual stockholders on the basis of their stock ownership; is that correct? A. Yes, sir.

Q. And without relation to any evidence of what either of them actually received?

A. I made an attempt at a determination for what they had actually received, and I could not identify the amounts, and therefore used the stock ownership.

(Testimony of Donald E. Phillips.)

Q. Well, now, as a matter of fact, and aside from the schedules to which I have called your attention and which are [230] here in evidence as Petitioners' 9, 10, 11, and 12, and with the further exception of those items which are set forth on the schedule of payments, the source of payments made to Fred Keenan of Keenan Pipe & Supply Company, did you find any specific items of cash going to the petitioners Archie or Fawn Koyl?

A. I have not had an opportunity to determine from those schedules whether they are correct or incorrect.

Q. Well, they are very brief. With reference to the year 1946, there were three items representing corporation checks used for materials or services on Mr. Koyl's home. Did you find any items going to Mr. Koyl directly or indirectly, specific items, in the year 1946, other than those three?

Mr. Machtinger: If your Honor please, I object to that question. The witness has testified to the manner in which he prepared his work papers and allocated the income of the corporation. He has also testified that he attempted to discover what specifically went to the individual stockholders, and could not. I think counsel is merely repeating his questions now.

The Court: I don't think so, Mr. Machtinger. The witness hasn't indicated that he couldn't find anything. He asserts that he couldn't find anything which he considered adequate for the purpose. But here he is shown certain specific items and he is

(Testimony of Donald E. Phillips.)

asked if he found any others. I think he must answer that question; either did or he didn't. He has a record of them or doesn't have a record of them.

A. The petitioner Fawn Koyl received \$200 on February 1, 1947, which she placed in an account called "Trustee for Rodney S. Koyl."

Q. Where did she receive that money?

A. I don't know, sir.

Q. And from whom did she receive it?

A. I don't know. She placed it upon the bank——

Q. The fact that the——

Mr. Machtinger: Will you let the witness answer the question that you asked? I didn't understand that he had finished itemizing what the petitioners had received.

Do you have any more that you want to point out?

The Witness: That's right.

Mr. Machtinger: I think he should be entitled to answer the full question before you interrogate him any further.

Mr. Campbell: I have asked him concerning 1946. He has referred to a 1947 item.

Mr. Machtinger: I didn't understand your question referring to a specific year. I am sorry.

Q. (By Mr. Campbell): All right. What specific items did you find were received from the corporation by either Archie or Fawn Koyl in 1946, in addition to these three items?

(Testimony of Donald E. Phillips.)

A. I have no identification of anything coming from the corporation. [232]

Q. Other than these three items?

A. Other than the fact that there were travel expense checks and similar checks issued.

Q. Well——

A. But I do not know as to the receipt of said checks.

Q. As to travel checks received by Mr. Koyl, did you find that any of those checks were deposited by him in his account?      A. Not in 1946.

Q. All right. Did you have anything of any individual items received by the Koyls from the corporation in 1946?      A. No.

Q. You do not?      A. No, sir.

Q. Directing your attention to the year 1947, as Petitioners' 10, there is set forth there certain items as having been received from the corporation by Mr. Koyl in addition to those reported on his return. Do you have any items of any specific items which either he or Fawn Koyl received from the corporation, in addition to the items set forth there?      A. No, sir, I do not.

Q. I call your attention to Exhibit 11, with reference to the year 1948, wherein there are set forth certain items as having been received, and deposited in the account of Koyl, of sales of the corporation. Did you find any additional, specific items that Mr. Koyl or his wife received from the corporation in [233] 1948, other than those reported in their returns and as set forth on this schedule?

(Testimony of Donald E. Phillips.)

A. No, sir.

Q. I call your attention to Exhibit 12 with relation to the year 1949, in which there is set forth an item of credit of the corporation's check, and ask you if you found in your examination any specific items which Mr. Koyl or his wife received in 1949 from the corporation, other than as set forth in his return for that year, or upon this schedule?

A. If you mean "from the corporation" by one of its checks—no, sir.

Q. No, I didn't ask "by one of its checks." At any time, I said, from the corporation.

A. Do I understand you to mean from unreported income, sir?

Q. I asked from the corporation.

A. Only the unidentifiable bank deposits.

Q. Well——

A. To their various accounts.

Q. But you have no specific items, is that correct? A. No, sir.

Q. Now, you have referred to the bank account of Mr. Koyl and what you have termed unidentified deposits therein. And, as a matter of fact, you then carried into your report of the corporation those items which you termed unidentified bank deposits in Mr. Koyl's individual account as being additional income to the corporation, did you not?

A. Yes, sir.

Q. And did you do so only on the basis that you did not, in the course of your investigation, find



(Testimony of Donald E. Phillips.)

what the source of those particular deposits were, is that right?

A. No, sir. During the course of my investigation, I interrogated Mr. Koyl about the East Side Plumbing Company and the Koyl Plumbing Company, for which he received credit upon his re-entry into the corporation for large plumbing inventory, but was never given any records to substantiate such an operation.

Q. Well, you ascertained——

The Court: Let him finish.

Mr. Campbell: I am sorry.

A. (Continuing): And therefore the unidentified bank deposits in many cases appeared to me to have been from some type of individual plumbing company operation.

Q. (By Mr. Campbell): But you charged those to the corporation, did you not?

A. No, sir, not while he was outside the corporation.

Q. And that, then, refers only to the year 1948?

A. Yes, sir.

Q. But as to the other years, 1947, 1949, and 1950, did you charge the unidentified, what you term unidentified deposits in his personal accounts as income of the corporation?

A. Yes, sir, I did. [235]

Q. And then, as I understand you, in 1948 you charged it as income, these deposits as income to Mr. Koyl on the theory or the basis that he was conducting a private business?

(Testimony of Donald E. Phillips.)

A. Yes, sir, he had so informed me.

Q. And did you in that connection make any allowance for costs of doing business?

A. I asked him for such records and received none.

Q. As a matter of fact, he told you, did he not, that he was not in the plumbing business, but was acquiring materials in contemplation of entering the plumbing business?

Mr. Machtinger: Objection. What he told the witness is hearsay.

The Court: No, I don't think so. It doesn't have to be true, but the witness has testified that Mr. Koyl admitted to him he was in the business. Now, counsel is asking him on cross examination whether he didn't say something else. The witness can answer whether Mr. Koyl told him that or not.

A. He and his representatives have both stated to me that they bought for cash at auctions. They traded materials for other strategic materials, and yet never produced a record to substantiate it.

Q. (By Mr. Campbell): That is as to the acquisition of materials. What were you told with reference to the conduct of the business?

A. Only that he had started one. [236]

Q. Only that he was acquiring materials?

A. He just said that he had started a company.

Q. All right. Were you informed that the company was operated, that is, by the sale of material or by the sale of services, or did you presume that?

A. I presumed that.

(Testimony of Donald E. Phillips.)

Q. Yes. All right. Now, coming to these bank accounts, did you make any effort, during the course of your investigation, to determine the source of all of the funds which went into his bank account?

A. Yes, sir, I did.

Q. You knew, as a matter of fact, did you not, that during the years '48, '49, and '50, or that portion of '50 which is involved in the corporation return, that Mr. Koyl had a number of rental properties?

A. Yes, sir, I did.

Q. And that he was receiving substantial amounts of rent from those properties, is that right?

A. Yes, sir.

Q. And, incidentally, was reporting them on his returns, isn't that correct?

A. He was reporting rental incomes.

Q. Now, isn't it a fact that during the year 1947—pardon me—during the fiscal year of the corporation ending 1947, that Mr. Koyl deposited a total in his accounts of [237] \$2,694.60?

A. I do not know that, sir.

Q. Will you examine your records? You state you had made an analysis of his bank accounts?

A. I made them on a calendar-year basis.

Q. Well, as to 1947, '49, and '50, fiscal years of the corporation, you were adding those deposits, unidentified deposits to the corporation income, were you not?

A. Yes, sir, I was.

Q. Do you have a breakdown of that?

A. I have the bank deposit records here, but I

(Testimony of Donald E. Phillips.)

A. Yes, sir, he had so informed me.

Q. And did you in that connection make any allowance for costs of doing business?

A. I asked him for such records and received none.

Q. As a matter of fact, he told you, did he not, that he was not in the plumbing business, but was acquiring materials in contemplation of entering the plumbing business?

Mr. Machtinger: Objection. What he told the witness is hearsay.

The Court: No, I don't think so. It doesn't have to be true, but the witness has testified that Mr. Koyl admitted to him he was in the business. Now, counsel is asking him on cross examination whether he didn't say something else. The witness can answer whether Mr. Koyl told him that or not.

A. He and his representatives have both stated to me that they bought for cash at auctions. They traded materials for other strategic materials, and yet never produced a record to substantiate it.

Q. (By Mr. Campbell): That is as to the acquisition of materials. What were you told with reference to the conduct of the business?

A. Only that he had started one. [236]

Q. Only that he was acquiring materials?

A. He just said that he had started a company.

Q. All right. Were you informed that the company was operated, that is, by the sale of material or by the sale of services, or did you presume that?

A. I presumed that.

(Testimony of Donald E. Phillips.)

Q. Yes. All right. Now, coming to these bank accounts, did you make any effort, during the course of your investigation, to determine the source of all of the funds which went into his bank account? A. Yes, sir, I did.

Q. You knew, as a matter of fact, did you not, that during the years '48, '49, and '50, or that portion of '50 which is involved in the corporation return, that Mr. Koyl had a number of rental properties? A. Yes, sir, I did.

Q. And that he was receiving substantial amounts of rent from those properties, is that right? A. Yes, sir.

Q. And, incidentally, was reporting them on his returns, isn't that correct?

A. He was reporting rental incomes.

Q. Now, isn't it a fact that during the year 1947—pardon me—during the fiscal year of the corporation ending 1947, that Mr. Koyl deposited a total in his accounts of [237] \$2,694.60?

A. I do not know that, sir.

Q. Will you examine your records? You state you had made an analysis of his bank accounts?

A. I made them on a calendar-year basis.

Q. Well, as to 1947, '49, and '50, fiscal years of the corporation, you were adding those deposits, unidentified deposits to the corporation income, were you not? A. Yes, sir, I was.

Q. Do you have a breakdown of that?

A. I have the bank deposit records here, but I



(Testimony of Donald E. Phillips.)

do not have them summarized in the same way you do, sir.

Q. Well, I am going to show you a summary which I have in my hand, which purports to show on the fiscal year basis an analysis of receipts and cash coming into the possession of Mr. Koyl, the total amount of bank deposits for the same periods, and ask you if this corresponds, or the figures set forth hereon, correspond with those developed by you in the course of your examination? [238]

\* \* \* \* \*

A. I do not know specific items could be picked out by me. But in trying to reconcile anything that I have on a calendar-year basis for a fiscal-year computation such as you have, I would have to check each individual item.

Q. Yes. All right. Now, in the fiscal year 1947, ending April 30, 1947, what amount of the Koyls' bank accounts did you charge as additional income to the corporation?

A. \$500 from the Fawn Koyl "Trustee for Rodney S. Koyl" No. 21268 in the Citizens National Maywood Bank—Maywood Branch, rather.

Q. And on what basis did you charge that to the corporation?

A. On the basis that it had not been identified for me in compliance with my many requests.

Q. Did you request Mrs. Koyl to identify that for you?           A. No, I did not.

Q. All right. Now, is that the total amount that you——           A. No, sir.

(Testimony of Donald E. Phillips.)

Q. All right. What else?

A. \$159 of deposits in the Fawn Koyl "Trustee for David T. Koyl," term account No. 15713.

Q. What was the source of that money?

A. I do not know, sir.

Q. Did you charge that to the corporation?

A. Yes, sir, I did. [242]

Q. What else?

A. And \$830 deposits to the account of Archie Koyl, Citizens National Bank, Maywood Branch.

Q. What was the source of those funds?

A. I do not know, sir.

Q. All right. That covers the total?

A. Yes.

Q. What is the total amount in 1947?

A. Was that 1946 only you were asking for, sir?

Q. Yes.

A. \$140 against the Fawn Koyl "Trustee for David T. Koyl" No. 15713, was a 1947 item.

Q. What was the source of those funds?

A. I do not know, sir.

Q. The account referred to is a trustee account for one of the minor children of the parties, is that right?

A. Yes, sir, it was.

Q. Did you charge that to the corporation?

A. Yes, sir.

Q. All right.

A. Also, in that same account, a \$400 deposit, that is account No. 15713, in October of 1947.

Q. What was the source of that fund?

A. I do not know, sir.

(Testimony of Donald E. Phillips.)

Q. That was to the children's account? [243]

A. Yes, sir.

Q. All right.

A. And to another term account No. 21268, May 23, 1947, and October 1, 1947, a total of \$800.

Q. Is your testimony the same, no knowledge as to the source of those funds?

A. That's right, sir.

Q. Would your testimony be the same as to all of the bank account items that you have charged as corporation income, as arising from unidentified deposits in the bank accounts of Archie or Fawn Koyl, either for themselves or for their children?

A. Is this for all years?

Q. For all years.

A. With the exception of the September 1947 deposit to the Archie Koyl account, Citizens National Bank, Maywood Branch, of \$1,805.50, on October 1, 1947 of \$1,840.

Q. Aren't those the same Ben Lang checks concerning which we have previously had testimony?

A. Yes, sir, they are.

Q. All right.

A. Also, a J. W. Dyer, Incorporated check of December 22, 1947 of \$509.84.

Q. Do you know, aside from knowing the name of the maker of that check, do you know for what purpose it was paid? Did your investigation disclose that? [244]

A. It did, sir, but I would have to go back into this, if you will pardon me.

(Testimony of Donald E. Phillips.)

Q. This being one of the few exceptions, will you do so?

A. To the best of my memory, that was unreported income to the corporation.

Q. But it belonged to the corporation?

A. To the best of my recollection, sir, yes.

Q. What was it for?

A. I do not remember, sir.

Q. As a matter of fact, don't you remember, Mr. Phillips, as to that specific item, that that was a reimbursement for Mr. Dyer, a resident of San Diego, to Mr. Koyl for an accommodation purchase which the Koyls had made for him? Do you recall that?

A. I did not personally ever talk to Mr. Dyer.

Q. That fact was explained to you at the time, was it not? Were you advised? A. By whom?

Q. By Mr. Koyl. Do you recall that?

A. No, I do not, sir.

Q. All right. Aside from those items that you have directed attention to, is your testimony the same as to the balance of the bank accounts charged as corporation income?

A. No, sir, I still have some more items.

Q. All right.

A. We have an Archie Koyl account in the Bell Gardens [245] bank, Bell Gardens; up to the time that I had written my report, Mr. Koyl had never informed me that he had such a bank account, although on many occasions I had asked him for a full list of bank accounts.

(Testimony of Donald E. Phillips.)

Mr. Campbell: I ask that that last be stricken as not responsive to the question.

Mr' Machtinger: I object to having that stricken, your Honor. It is responsive to the question of where——

The Court: No, I do not think so. But if you ask him the same question on redirect, I will overrule any objection to it.

Mr. Campbell: I withdraw the motion then.

The Court: It is in the record, then.

A. A deposit in 1947 of \$826, Harry McCabe.

Q. (By Mr. Campbell): That is the same item which is set forth on Petitioners' Exhibit 10, is it not, of \$826? A. Yes, sir, it is.

Q. All right. Now, what else?

A. 1948, item of \$600, Frodsham, Monty.

Q. That is the same item as set forth on Petitioners' Exhibit 11, is it not?

A. Yes, sir, it is. A Ben Lang item of \$1,055.50.

Q. That is also set forth on Petitioners' Exhibit 11, is it not? [246]

A. Yes, sir, it is. And an \$850 item, Monty Frodsham.

Q. That is also set forth on Petitioners' Exhibit 11, is it not? A. Yes, sir, it is.

Q. What else do you have?

A. In the fiscal year ended April 30, 1950, on page 79 of my report, to the Archie Koyl account, Citizens National Bank, Maywood Branch, item——

Q. What is the date?



(Testimony of Donald E. Phillips.)

A. July 19, 1949. Earl Bryan, \$52.50, Earl Bryan, 151.28.

Q. Just a moment, please. That is the same item as set forth on Petitioners' Exhibit 13, is that correct?

A. It is the same amount, sir.

Q. Same date too, is it not?

A. Yes, sir, it is.

Q. And the same maker, is it not?

A. Yes, sir, it is.

Q. All right. Now, what is your next one?

A. Earl Bryan, August 12, 1949, \$213.60.

Q. That is also set forth on Petitioners' Exhibit 13, is it not? A. The amount is, sir.

Q. And the date? A. There is no date there.

Q. Isn't that indicating the date above, 8/12/49?

A. If that mark means a ditto, it is, sir.

Q. The checks under the word "Earl Bryan," doesn't that indicate Earl Bryan?

A. All right.

Q. Is there any doubt in your mind that is the same item? A. No, sir.

Q. All right. Let's got on to the next.

A. Earl Bryan, amount of \$36.55.

Q. On what date?

A. August 12, 1949.

Q. That is also set forth on Petitioners' 13, is it not?

A. Yes, sir, it is. Baker Construction Company check dated—in deposit—dated December 13, 1949, \$619.

(Testimony of Donald E. Phillips.)

Q. That is also on Petitioners' 13, is it not?

A. Yes, sir. All right, Earl Bryan check, in deposit of September 13th, the amount of \$276.77.

Q. That is also on Petitioners' Exhibit 13, is it not?

A. Yes, sir, it is. Earl Bryan check in the deposit of January 5, 1950, the amount of \$500.

Q. That is also on Petitioners' Exhibit 13, is it not?

A. Yes, sir. A Basford N. Edwards check in the deposit of January 9, 1950 of \$158.62.

Q. That is also on Petitioners' 13, is it not?

A. Yes, sir, it is. A Virgil Burmood check, in the January 9, 1950 deposit, of \$222.09. [248]

Q. That is also on Exhibit 13, is it not?

A. Yes, sir, it is. Virgil Burmood check in the deposit of February 3, 1950 of \$247.06.

Q. That is also on Exhibit 13, is it not?

A. Yes, sir, it is. Earl Bryan check of \$200 in the deposit of March 13, 1950.

Q. How much? I thought you said March 13th. March 10th, is it not?

A. It is in the March 13th deposit. These may be the date of the checks.

Q. Yes. You find such an item dated March 10, 1950 on Exhibit 13?

A. Yes. And an amount of \$88.10 from Virgil Burmood in this same deposit of March 13th.

Q. That is also listed here on Exhibit 13?

A. Yes, as of the date of March 11th.

Q. All right. Have we covered all of the identi-

(Testimony of Donald E. Phillips.)

fied items which you have charged the corporation?  
A. Yes, sir.

Q. And I take it then as to all other items of bank deposits from Archie and Fawn Koyl bank accounts, or the children's bank accounts, your investigation did not disclose the source of those funds; is that correct?

A. That is right, sir.

Mr. Campbell: I am going to ask that this document [249] which was shown the witness, but of which he could make no comparison, which is entitled, "Analysis of Receipts, Bank Deposits and Cash Fund," be given a number for identification.

The Clerk: Petitioners' Exhibit 21 for identification.

(Petitioners' Exhibit Number 21 was marked for identification.)

Q. (By Mr. Campbell): Mr. Phillips, in connection with your examination of the affairs of Archie and Fawn Koyl, and for the purpose of determining whether or not your proposed finding that they received, constructively or otherwise, the amounts as set forth by you in your report, did you make investigation of the net worth of Archie and Fawn Koyl for the years in question?

A. Not in particular, sir.

Q. You say "not in particular." Did you make up a schedule in general as to their net worth?

A. I never did, sir.

Q. Well, now, wasn't there presented to you a net worth summary relating to Archie and Fawn

(Testimony of Donald E. Phillips.)

Koyl for all years from 1944 to 1950, inclusive?

A. At various times, many so-called net worth or cash-in and cash-out statements were submitted on behalf of the taxpayer to me.

Q. And I presume you made examination of those for the [250] purpose of determining whether or not your findings, which were the basis of the Commissioner's findings, were correct, did you not?

A. Yes, sir, I did.

Q. I am going to show you a two-page document.

Mr. Campbell: I will ask to have this two-page document, which is headed "Archie and Fawn Koyl Net Worth Summary, 1944 to 1950" marked for identification.

The Clerk: Petitioners' Exhibit 22 marked for identification.

(Petitioners' Exhibit Number 22 was marked for identification.)

Q. (By Mr. Campbell): I will ask you if this particular document of the net worth of Archie and Fawn Koyl was presented to you during the course of or prior to your appearance here, the original of which this is a photostatic copy?

A. This is not dated, nor does it have anyone's signature.

Q. That was not my question, sir.

A. I do not know if I have ever seen the original of this document, sir.

Mr. Campbell: Will it be stipulated that the

(Testimony of Donald E. Phillips.)

original of this document or a duplicate of this document was furnished to the Government?

Mr. Machtinger: I don't question that it was, but in [251] all sincerity I don't recall ever having seen it. It may have been presented——

The Court: Mr. Campbell, you are not going to be able to bring that in the picture unless somebody establishes it, anyhow.

Mr. Campbell: Yes, your Honor.

The Court: If it was presented, the person who presented it can testify if he recalls.

Q. (By Mr. Campbell): Do you have any net worth computation that you worked up, Mr. Phillips?      A. No, sir, I do not.

Q. Now, what investigation did you make, Mr. Phillips, to determine if the taxpayers actually received the sums of money which you charged them with in your reports?

Mr. Machtinger: I believe the witness has testified to the manner in which he attributed the income to the taxpayers and his investigation with respect to the bank deposits.

Mr. Campbell: I understand that, but I want to see now what investigation he made as to whether they received it.

Mr. Machtinger: I think he also testified that, to the effect that he didn't investigate or set up his schedules on the basis of whether they actually received it, but on the basis that they constructively received these funds.

Mr. Campbell: Well, I understood from him, his



(Testimony of Donald E. Phillips.)

[252] definition, that a constructive dividend was a payment in cash or property of an undeclared dividend.

The Court: What the witness testified to, he didn't know whether they got it or not. He had no way of determining whether they got it or not, and he attributed it on a 70-30 basis, in accordance with stockholdings.

Isn't that correct?

The Witness: That's correct.

Mr. Campbell: May I have just a moment, Your Honor?

Q. (By Mr. Campbell): In connection with your analysis of the corporation and of Mr. Koyl's affairs, did you attempt to ascertain what specific amounts Mr. Clark secured?

Mr. Machtinger: Objection, Your Honor. The specific amounts that Mr. Clark secured have no bearing here, if we are still working on our 70-30 theory.

The Court: Well, I don't know that it would have any bearing except that, conceivably, if Mr. Clark actually received more than 70, it might indicate that this petitioner received less than 30. I don't know where it is going to get to, but I am certainly not going to go into this case as to the details of what Mr. Clark got or didn't get. But I am willing to go far enough for this witness to indicate generally whether he had specific information as to Clark or not. After all, he is an accountant. If he handled it as to one, he might have done [253]

(Testimony of Donald E. Phillips.)

some calculation as to the other. It is up to him to speak. So go ahead and answer the question.

A. In some specific instances, I could trace amounts to Mr. Clark's.

The Court: Do they represent the full 70 percent that you attributed to Mr. Clark, or anything like it?

The Witness: There is no percentage determination from the actual amounts traceable, Your Honor.

The Court: I understand. But do they have any relationship in total amounts to 70 percent, those that you traced specifically into Mr. Clark's account?

The Witness: No, sir.

The Court: Broadly speaking, did you have any better basis for attributing to Mr. Clark than you did to attribute to Mr. Koyl?

The Witness: No, sir, I did not.

The Court: All right. [254]

\* \* \* \* \*

Mr. Campbell: It will be stipulated with respect to Exhibit 19, which has heretofore been admitted for a limited purpose, that the figures thereon represent the income of the corporation as corrected; that the references thereon are to the revenue agent's report showing the amounts which have been added to or subtracted from income with reference to the findings of the revenue agent, and which were the basis of the 90-Day Letter in the corporation case.

(Testimony of Donald E. Phillips.)

It will be stipulated that the figures of corrected income as set forth hereon are the true and correct income of the corporation for the years in question.

Mr. Machtinger: I think we should make it clear to the Court that it is these figures which were used as the basis for arriving at the stipulated deficiency in the corporation case.

The Court: I understand. And now, for the purpose of this case, you agree they are correct?

Mr. Machtinger: Yes, sir.

The Court: All right.

Mr. Campbell: That is all.

#### Redirect Examination

Q. (By Mr. Machtinger): You testified in cross examination that constructive dividends mean money taken by the person to whom those dividends are charged. Is the meaning of constructive dividends necessarily limited to money actually taken?

Mr. Campbell: Objected to as calling for his legal conclusion.

The Court: I don't think it is necessary to go into that. Constructive dividends usually do have a special connotation somewhat different than the term as used by this witness. But he has explained clearly enough what he meant by it.

Mr. Machtinger: If the Court please, the witness has testified from work papers, setting forth the cash receipts unidentified as compared to the deposit items unidentified. I would like to offer these work papers in evidence as Respondent's next in order.

(Testimony of Donald E. Phillips.)

Mr. Campbell: I have no objection.

The Court: Very well. They will be received.

The Clerk: Respondent's Exhibits J, K, L and M admitted in evidence.

(Respondent's Exhibits J, K, L and M were marked for identification and received in evidence.)

Q. (By Mr. Machtinger): You testified that you prepared these work papers, identified as Respondent's Exhibits J, K, L and M from other work papers. From what work papers or schedules did you prepare [256] these schedules?

A. From work papers containing a transcript of the bank deposit items of all of the bank deposits made by the Gene Clark, Incorporated.

Q. Does that schedule contain all of the bank deposits and the items listed on those bank deposits for all four years involved here?

A. Yes, they do.

Mr. Machtinger: Will counsel stipulate that the schedule set forth here corresponds to the items set forth on the bank deposits as deposited by the corporation for the four years involved?

Mr. Campbell: I have no way of determining——

Mr. Machtinger: We could subpoena——

The Court: Mr. Campbell, it certainly would be a little bit ridiculous to bring the bank's records here. Can't you——

Mr. Campbell: I agree to that.

The Court: ——stipulate them subject to check?

Mr. Campbell: I was about to make——

(Testimony of Donald E. Phillips.)

The Court: We can give you an opportunity to check them. If you find anything wrong with them, then I will reopen, if necessary, for that purpose.

Mr. Campbell: I was about to make that suggestion, Your Honor. [257]

The Court: All right.

Mr. Machtinger: Thank you, sir.

Mr. Campbell: Those are the corporation?

Mr. Machtinger: Those are the corporation.

Mr. Campbell: May I make this suggestion, then: I think we have available the original transcripts, if you are agreeable that they be substituted for those.

Mr. Machtinger: I have no objection to substituting the original transcripts.

Mr. Campbell: All right.

The Court: Let's get them and substitute them. It doesn't have to be done at the moment. It is understood they will be substituted, and of course they will be subject to your check, Mr. Machtinger.

Q. (By Mr. Machtinger): Mr. Phillips, did you compare the items set forth on the bank deposit slips of the corporation to the cash receipts journal of the corporation? A. Yes, sir, I did.

Q. What does your schedule show, if anything, with respect to such comparison?

A. Wherever an amount was the same that was in the bank deposit, as the cash receipt, I placed the number of the cash receipt to the right of the items or the ABA number appearing for that item, in this transcript. [258]



(Testimony of Donald E. Phillips.)

Q. Did you find that all items listed in the cash receipts journal were correspondingly listed as some item on the cash deposit slip? A. No, sir.

Q. Did you prepare a schedule setting forth those items which you discovered in the cash receipts journal which were not included as a specific item in the cash deposit slip?

A. Yes, sir, I did.

Q. Do you have such schedule?

A. They are incorporated in those schedules that you just put in.

Q. Referring to the schedules identified as Respondent's Exhibits J, K, L and M, can you explain to the Court, through an example, of an item that was listed in the cash receipts journal but for which there was no corresponding item listed in the bank deposit slips, and what you did on your work sheets when you discovered such a fact?

Mr. Campbell: Is he looking for some specific one? He has turned over some nine sheets up to this time.

Mr. Machtinger: I asked the witness to give an example to the Court of how he would handle such an item. I imagine he is looking for one which would be simple to explain.

A. On the unidentified deposit items listed in the deposit dated June 14, 1947, in the total amount of \$14,260.30, the unidentified cash receipt of \$1,900 for Charles Hasekian [259] could not be matched to the—that particular day's deposit, and there is a note, "Cash receipt, 4,620," that \$1,900 was not

(Testimony of Donald E. Phillips.)

deposited. On the deposit dated June 20, 1947 in the total amount of \$11,813.24, an unidentified item of deposit of \$2,445, a check from Hamilton Homes, No. 1385, dated June 13, 1947, was deposited. No cash receipt in the amount of \$2,445 for the account of Hamilton Homes was found in the set of books of Gene Clark, Incorporated during this period.

Q. (By Mr. Machtinger): Can you identify the specific page to which you are now referring?

A. It is page 2 of 9 of Exhibit M.

Q. Did you discover whether or not the corporation ever cashed checks for its employees, let's say salary checks of employees?

A. Many checks issued by Gene Clark, Incorporated were included in their deposits.

Q. Such a deposit would not be correspondingly included in the sales journal, would it?

A. No, sir, it would not.

Q. Did you add the total amount of such checks to the corporate income? A. No, sir, I did not.

Q. Did you attempt to trace the source of these checks for which there was no corresponding entry in the cash receipts [260] journal, or no corresponding entry in the sales journal?

A. Yes, and some of them were identified.

Q. Did you ask the representatives of the petitioners as to an explanation of the source of these unidentified checks? A. Yes.

Q. Did you ask the representatives of the corporation as to the source of these unidentified checks? A. Yes.

(Testimony of Donald E. Phillips.)

The Court: Did they answer your inquiries or not?

The Witness: Specifically, Fred Files, who is office manager, said that it was a regular practice to substitute checks, and that Gene Clark carried many checks of customers in his pockets, and would bring them in and substitute them for cash.

Q. (By Mr. Machtinger): Did you ask those questions of Gene Clark or Archie Koyl?

A. I never talked to Gene Clark during the course of this investigation.

Q. Did you talk to Mr. Koyl?

A. Yes, sir, I did.

Q. Did you ask him as to the source of these unidentified checks?

A. Yes, sir, I did.

Q. Did he answer you? [261]

A. Not as to identifying any of the specific items.

Mr. Campbell: I ask that that be stricken as not responsive.

Q. (By Mr. Machtinger): Did he answer you?

The Court: What did he answer?

Mr. Campbell: That's a negative——

The Witness: He answered that it was common practice for Gene to take currency and to replace them with checks, and that as far as he could remember that he hadn't done it.

Q. (By Mr. Machtinger): Was it possible for you in the course of your examination of the books

(Testimony of Donald E. Phillips.)

and records of the corporation to determine who got these unidentified proceeds?

A. No, sir, it was not possible.

Q. Referring you to Petitioners' Exhibit 13, Mr. Phillips, did you in the course of your investigation discover whether or not the payments made by the individuals listed on this exhibit were amounts which were owing by these individuals to the corporation?

Mr. Campbell: I will stipulate, Mr. Machtinger, that they were. I have those people's files here, if there is any question, but I will stipulate.

Mr. Machtinger: So stipulated. [262]

Q. (By Mr. Machtinger): Did the corporation include these amounts as income?

Mr. Campbell: I will stipulate that the corporation—go ahead. Let him answer it.

A. No, they did not.

Q. (By Mr. Machtinger): Referring you to the two Ben Lang checks identified as Respondent's Exhibits B and C, it has been testified to by Mr. Koyl that these payments of \$1,805.50 and \$1,840 were made in consideration of debts due the corporation. Does your investigation disclose whether or not the corporation included these amounts as income?

Mr. Campbell: Just a moment. I think by way of our settlement we have agreed that they were not income to the corporation—I mean by way of our stipulation.

(Testimony of Donald E. Phillips.)

Mr. Machtinger: Well, our stipulation gives the total figure.

Mr. Campbell: I beg your pardon. I was thinking of another item. They were income to the corporation.

Mr. Machtinger: Will you stipulate that they were income to the corporation?

Q. (By Mr. Machtinger): Did the corporation include it on its records as income?

Mr. Campbell: I think that is covered by the stipulation. I think they did not. [263]

Q. (By Mr. Machtinger): Do your records show whether there were any items, any checks substituted in the corporate bank deposit to account for the \$1,805.50 and \$1,840 which were not deposited to the corporation bank account?

A. These were not substituted items. They were not deposited to the bank account of the corporation.

Mr. Campbell: While counsel is doing that, may I see that Hasekian item? I want to get the date of it, if your Honor please.

Q. (By Mr. Machtinger): In the course of your investigation, Mr. Phillips, did you discover whether or not there had been travel and expense checks made out by the corporation in favor of Mr. Koyl? A. Yes, sir.

Q. Would not the proceeds of such checks be received by Mr. Koyl whether or not the checks were deposited in his account, if he so cashed the checks?



(Testimony of Donald E. Phillips.)

Mr. Campbell: If he knows.

Q. (By Mr. Machtinger): If you know.

A. I don't know what would happen to the proceeds of those checks.

Q. But if he cashed the checks, then the amounts would not necessarily be deposited as a check item in his own bank [264] accounts, would they?

Mr. Campbell: Objected to as argumentative.

The Court: Well, the question answers itself. If he cashed them, he didn't deposit them. If he deposited them, he didn't cash them.

Q. (By Mr. Machtinger): With respect to the items deposited in the bank accounts of Mr. or Mrs. Koyl, whom did you ask as to the source of the funds which were deposited in such bank accounts?

Mr. Campbell: I think that has been covered by the stipulation. Those were eliminated from corporate income, I think, Mr. Machtinger.

Mr. Machtinger: I think it might be pertinent in that, although we have agreed as to the amount of corporate income, there has not been any agreement as to the amount of such income which went to Mr. Koyl. There was testimony on cross by Mr. Phillips that he did not ask Mrs.—

Mr. Campbell: For that purpose I withdraw the objection.

A. The only ones I ever asked were Mr. Koyl or representatives of the company, such as Benny Kay or Fred Files.

Q. (By Mr. Machtinger): Did you ask Mr.

(Testimony of Donald E. Phillips.)

Koyl as to the source of the funds deposited in Mrs. Koyl's bank account?

A. Yes, sir, I did. [265]

Q. Did he give you an answer?

A. Only by submission of a cash-in and cash-out statement.

Q. Was it your understanding that Mr. Koyl was endeavoring to answer on behalf of Mrs. Koyl as to the source of those funds?

A. Yes, sir, it was.

Q. Did Mr. Koyl ever refer you to Mrs. Koyl for those answers?

Mr. Campbell: Objected to as immaterial.

Mr. Machtinger: In view of the question on cross as to whether or not he had never interviewed Mrs. Koyl, I think that question is pertinent.

The Court: Well, Mr. Machtinger, does it make any difference? These were community-property returns. It has been conceded right straight through that they represented half of the income, that Mr. Koyl was the one who produced it, and no one has raised any question about his right to speak for his wife under those circumstances.

Mr. Machtinger: No more questions. [266]

\* \* \* \* \*

[Endorsed]: Filed April 18, 1955.

[Endorsed]: No. 16010. United States Court of Appeals for the Ninth Circuit. Gene O. Clark and Faye Clark, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: May 7, 1958.

Docketed: May 9, 1958.

Supplemental Filed: June 4, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for  
the Ninth Circuit.

---

United States Court of Appeals  
For The Ninth Circuit

No. 16010

GENE O. CLARK, FAYE CLARK,

Petitioners on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent on Review.

### STATEMENT OF POINTS

Petitioners on Review intend to rely upon the following points:

That the Tax Court of the United States erred:

#### I.

In holding and finding that Petitioners on Re-

view did not sustain their burden of proof for each of the years 1946 and 1947.

## II.

In holding and finding that the determination of Respondent on Review was not arbitrary, capricious, erroneous, and invalid.

## III.

The findings of fact of the Tax Court are not supported by the evidence.

## IV.

In holding and finding that Gene Clark, Inc., a California corporation, received substantial amounts of taxable income from unreported sales, which it failed to report on its returns for the fiscal years ending April 30, 1947 and 1948.

## V.

In its determination of the amounts of alleged unreported income of Gene Clark, Inc., for its fiscal years ending April 30, 1947 and 1948.

## VI.

In its allocation of alleged unreported income of Gene Clark, Inc. for its fiscal years ending April 30, 1947 and 1948, to Petitioners on Review for their calendar years 1946 and 1947.

## VII.

In holding and finding that alleged corporation income which Respondent on Review asserted and

determined was not available for distribution by Gene Clark, Inc., for its fiscal years ending April 30, 1947 and 1948, was available for distribution and was distributed to Petitioners on Review for the calendar years 1946 and 1947.

### VIII.

In its failure to accrue and deduct State of California franchise taxes and fraud penalties from the amount alleged to be available for distribution from Gene Clark, Inc., for its fiscal years ending April 30, 1947 and 1948.

### IX.

In its failure to deduct State and Federal fraud penalties of Gene Clark, Inc., for its fiscal year 1947 and State and Federal franchise and income taxes, respectively, for its fiscal year 1948 from the amount the Court determined on a theoretical basis was distributed to Petitioners on Review, out of the alleged unreported income of Gene Clark, Inc., for its fiscal year 1948.

### X.

In holding and finding that Petitioners on Review withheld and diverted to their own purposes, substantial amounts of the proceeds of alleged unreported sales, and that they realized informal or constructive dividends from Gene Clark, Inc., for the calendar years 1946 and 1947.

### XI.

In its determination of the amounts of alleged



diverted proceeds from alleged unreported sales and the amounts of the alleged unreported income from informal or constructive dividends from Gene Clark, Inc., for the calendar years 1946 and 1947.

## XII.

In holding and finding that Gene Clark, Inc., did not make certain loans to Petitioners on Review and that the amounts so received by Petitioners on Review were constructive dividends to them.

## XIII.

In holding and finding that the assessment and collection as to Petitioner on Review Gene O. Clark was not barred by the Statute of Limitations as to the years 1946 and 1947, and that the assessment and collection as to Petitioner Faye Clark was not barred by the Statute of Limitations as to the year 1947.

## XIV.

In holding and finding that Respondent on Review sustained his burden of proof to show an omission of income of more than 25% from Petitioner on Review Gene O. Clark's income tax return for the calendar year 1946 and for both Petitioners on Review for the calendar year 1947.

## XV.

In holding and finding that Petitioner Gene O. Clark filed false and fraudulent income tax returns for the years 1946 and 1947, and that a part of

his deficiency for each of said years was due to fraud with intent to evade taxes.

Dated: June 10, 1958.

Respectfully submitted,

BAIRD & HOLLEY,  
/s/ By THOMAS A. BAIRD,  
Attorneys for Petitioners on  
Review.

Certificate of Service Attached.

[Endorsed]: Filed June 11, 1958. Paul P. O'Brien, Clerk.

---

[Title of Court of Appeals and Cause.]

### STIPULATION RE PRINTING OF EXHIBITS

It is hereby stipulated by and between counsel for the respective parties that none of the exhibits introduced into evidence in the above-entitled cases, including the exhibits introduced in connection with the testimony of Revenue Agent Donald E. Phillips, in the related but not consolidated cases of Archie M. Koyl, et al. v. Commissioner (T.C. Docket Nos. 48,336, 48,337 and 48,338), transcript of testimony taken March 29 and 30, 1955, (pp. 156-269), shall be printed, but that all of such exhibits, which are a part of the record of this Court, shall be treated as physical exhibits so that either party

to the appeal may refer to, quote from, or include in his, or her, or its brief, or on oral argument, any part or all of the said exhibits in the same manner as if the said exhibits were printed in the record in their entirety.

Dated: June 27, 1958.

/s/ CHARLES K. RICE,  
Counsel for Respondent on  
Review.

BAIRD & HOLLEY,  
/s/ THOMAS A. BAIRD,  
Counsel for Petitioners on  
Review.

[Endorsed]: Filed July 10, 1958. Paul P.  
O'Brien, Clerk.

